FINANCIAL SERVICES AND GENERAL GOVERNMENT APPROPRIATIONS FOR FISCAL YEAR 2009

WEDNESDAY, MARCH 5, 2008

U.S. SENATE,
SUBCOMMITTEE OF THE COMMITTEE ON APPROPRIATIONS,
Washington, DC.

The subcommittee met at 3 p.m., in room SD–138, Dirksen Senate Office Building, Hon. Richard J. Durbin (chairman) presiding.

Present: Senators Durbin, Brownback, and Allard.

DEPARTMENT OF THE TREASURY

STATEMENT OF HON. HENRY M. PAULSON, JR., SECRETARY OF THE TREASURY

OPENING STATEMENT OF SENATOR RICHARD J. DURBIN

Senator DURBIN. Good afternoon, and I'm pleased to convene a series of hearings to examine fiscal year 2009 funding requests. Today we launch our lineup with the Department of the Treasury.

Welcome, Secretary Henry Paulson, to the hearing room, along with any associates who would like to join in your testimony.

I welcome my colleagues who will join me shortly, and others who may arrive. Although, this is a budget hearing for the Treasury, we've scheduled a separate hearing next month to devote particular attention to the Internal Revenue Service (IRS), the Treasury's largest bureau. We'll defer the bulk of our questions relating to the IRS until that hearing.

The non-IRS portion of the Department's budget constitutes over $1.1 billion, supporting many critical activities in the central programs we'll concentrate on today.

The Department plays a pivotal role in the global economy, and as an ambassador for the Nation's economic and financial institutions. In fulfilling the mission, Treasury promotes economic prosperity, and ensures the financial security of our Nation.

Treasury also administers the world's largest collection system, over $2 trillion a year. In addition, Treasury supports financial institutions in generating community development, and leads Government efforts in the area of financial intelligence.

I'm pleased that for fiscal year 2008, we were able to provide additional funds for the Department to address several important needs. The funds will further support the Department's efforts to combat terrorism, through implementing economic sanctions, and gathering and analyzing financial intelligence.

For fiscal year 2009, the budget request for Treasury is $12.47 billion, an increase of $461.6 million, or 3.8 percent. Excluding IRS, the request for the remainder is $1.11 billion. This represents a net decrease of $7.5 million over fiscal year 2008, overall reduction of less than 1 percent. This would appear to be a very restrained budget for the non-IRS portion of the Department, however, the top line includes a 70 percent decrease from fiscal year 2008 funding level for the Community Development Financial Institutions Fund (CDFI), commonly known as CDFI.

Holding CDFI funding at the fiscal year 2008 level, the fiscal year 2009 President's budget reflect a $57.9 million, or 5.2 percent increase for the non-IRS portion of the Treasury Department. I'm concerned about this proposed cut in CDFI, which we will discuss later, because I believe that the infusion of capital to these institutions can help many distressed communities, and low-income individuals, who are facing the economic downturn, with more severity than most.

I think it's clear that adequate funding for CDFI is critically important.

For the Office of Terrorism and Financial Intelligence (TFI), including Financial Crimes Enforcement Network, known as FinCEN, the budget requests $153 million for fiscal year 2009, compared to $142.6 million last year, an increase of over $10 million. I'm pleased to see Treasury continues to emphasize strategies to counterterrorist financing and money laundering.

Beyond the Treasury Department, I also want to talk for a few minutes with the Secretary about broader economic issues. I know you've faced that already once today, so you've undoubtedly been prepared for this by my colleagues in the House.

I appreciate your insights on the current housing crisis and the state of the economy, and we'll have a few questions along those lines. I look forward to discussing them with you.

At this point, since Senator Brownback has not arrived, I would like to turn the floor over to the Secretary, and Mr. Secretary, you may proceed with your remarks.

Secretary PAULSON. Thank you, Senator Durbin—there we go.

Senator DURBIN. Thank you.

Secretary PAULSON. That's always the most difficult part of the hearings, turning on the microphone.

But, thank you very much for your remarks, and for your support of the Treasury. I very much appreciate the opportunity to discuss the Treasury Department's proposed fiscal year 2009 budget.

Our budget request reflects the Department's continued commitment to promoting a healthy U.S. economy, fiscal discipline, and national security. The Department has broad responsibility in Federal cash management, tax administration, and plays an integral role in combating terrorism, terrorist financing, and advocating the integrity of the U.S. and global financial systems.

Our spending priorities for the 2009 fiscal year fall into six main categories. I'll briefly describe their priorities and then take your questions.

Treasury has an important role to play as a steward of the U.S. economy, and provides—and our offices provide technical analysis, economic forecasting and policy guidance on issues ranging from Federal financing, to domestic and global financial systems.

Those functions are especially critical now, as the U.S. economy—through a combination of a significant housing correction, high energy prices, and capital market turmoil—has slowed appreciably.

Our long-term economic fundamentals are solid, and I believe our economy will continue to grow this year, although not nearly as rapidly as in recent years.

In response to economic signals early this year, the administration and Congress worked together to quickly pass, on a bipartisan basis, the Economic Stimulus Act of 2008, and I would like to thank this subcommittee for approving funds for the IRS and the Financial Management Service (FMS), to administer the stimulus check rebate program under the act, so thank you for that.

As you know, the stimulus payments to households, and the incentives to businesses in the act, together are estimated to lead to the creation of 500,000 jobs by year-end. This will provide timely and effective support for families in our economy, and it wouldn't be possible without your leadership.

Treasury's Office of Terrorism and Financial Intelligence (TFI) uses financial intelligence, sanctions, and regulatory authorities, to track and combat threats to our security, and safeguard the U.S. financial system from abuse by terrorists, proliferators of weapons of mass destruction, and other illicit actors.

To continue to build on our efforts to combat these threats, we are requesting an $11 million increase for TFI, including $5.5 million for the Financial Crimes Enforcement Network, to ensure effective management of the Bank Secrecy Act.

The budget request emphasizes infrastructure and technology investments to modernize business processes and improve efficiency throughout the Treasury Department. We will continue to make information technology management a priority, and have taken several significant steps to strengthen our systems and oversight.

Treasury is committed to managing the Nation's finances effectively, ensuring the most efficient use of taxpayer dollars in collecting the revenue due to the Federal Government. The IRS, of course, plays an integral role in all of this, the budget requests a 4.3 percent increase in IRS funding to expand IRS enforcement activities, improve compliance, reduce the tax gap, and continue improvements in taxpayer service.

In addition, we are asking your colleagues on the State, Foreign Operations Subcommittee to support funding both in multilateral development banks—noticeably, new replenishments for the World Bank's International Development Association (IDA), and the African Development Fund, and have forwarded a $400 million request for the first installment of a $2 billion clean technology fund that—with additional funding from other donors around the world, will help finance clean energy projects in the developing world, and make strides toward addressing global climate change.

Overall, the budget request reflects a prudent and forward-leaning approach to fulfilling the Treasury Department's core responsibilities to support our economy, managing the Government's finances, and ensuring financial system security.

PREPARED STATEMENT

I thank you for your past support and consideration of our work, and I look forward to working with you during your deliberations.

Thank you, and I welcome your questions.

[The statement follows:]

PREPARED STATEMENT OF HENRY M. PAULSON, JR.

Chairman Durbin, Senator Brownback, Members of the Committee: Thank you for the opportunity to discuss the Treasury Department's proposed fiscal year 2009 budget. Our budget request reflects the Department's continued commitment to promoting a healthy U.S. economy, fiscal discipline and national security. The Department has broad responsibility in federal cash management, tax administration and plays an integral role in combating terrorist financing and advocating the integrity of the U.S. and global financial systems.

Our spending priorities for the 2009 fiscal year fall into six main categories. I will briefly describe the priorities and then take your questions.

U.S. ECONOMIC STEWARD

Treasury has an important role to play as steward of the U.S. economy, and our offices provide technical analysis, economic forecasting and policy guidance on issues ranging from federal financing to domestic and global financial systems.

Those functions are especially critical now as the U.S. economy, through a combination of a significant housing correction, high energy prices and capital market turmoil has slowed appreciably. Our long term economic fundamentals are solid, and I believe our economy will continue to grow this year, although not as rapidly as in recent years.

In response to economic signals, early this year the Administration and the Congress worked together to quickly pass, on a bipartisan basis, the Economic Stimulus Act of 2008. And I would like to thank this subcommittee for approving funds for the IRS and the FMS to administer the stimulus check rebate program under that Act.

As you know, the stimulus payments to households and the incentives to businesses in the Act, together, are estimated to lead to the creation of half a million jobs by year-end. This will provide timely and effective support for families and our economy, and it wouldn't be possible without your leadership.

STRENGTHENING NATIONAL SECURITY

Treasury's Office of Terrorism and Financial Intelligence (TFI) uses financial intelligence, sanctions, and regulatory authorities to track and combat threats to our security and safeguard the U.S. financial system from abuse by terrorists, proliferators of weapons of mass destruction and other illicit actors.

To continue and build on our efforts to combat these threats, we are requesting an $11 million increase for TFI, including $5.5 million for the Financial Crimes Enforcement Network to ensure effective management of the Bank Secrecy Act.

Efficient Management of the Treasury Department

The budget request emphasizes infrastructure and technology investments to modernize business processes and improve efficiency throughout the Treasury Department. We will continue to make information technology management a priority, and have taken several significant steps to strengthen our systems and oversight.

FISCAL DISCIPLINE

Treasury is committed to managing the nation's finances effectively, ensuring the most efficient use of taxpayer dollars and collecting the revenue due to the federal government.

Enforcing the Nation's Tax Laws Fairly and Efficiently

The Internal Revenue Service, of course, plays an integral role in this. The budget requests a 4.3 percent increase in IRS funding.

As in the past three budget requests, we are proposing to increase IRS enforcement funding as a Budget Enforcement Act program integrity cap adjustment. IRS enforcement efforts have yielded record revenue collections. With the requested funding, the IRS will collect an estimated $55 billion in direct enforcement revenue in 2009.

The budget also includes a number of legislative proposals intended to target the tax gap and improve tax compliance, with an appropriate balance between enforcement and taxpayer service. These proposals are estimated to generate $36 billion over the next ten years.

INTERNATIONAL PROGRAMS

We will continue to focus efforts on supporting a stable and growing global economy, through on-going dialogue and initiatives with developing economies throughout Asia, Latin America and Africa.

In addition we are asking your colleagues on the Foreign Operations Subcommittee to support key objectives of the President's international assistance agenda. This includes funding for the multilateral development banks—notably new replenishments for the World Bank's International Development Association (IDA) and the African Development Fund.

Also included as a Foreign Operations priority is $400 million request for the first installment of a $2 billion clean technology fund that, with additional funding from the United Kingdom, Japan and other donors, will help finance clean energy projects in the developing world and make strides towards addressing global climate change.

CONCLUSION

Overall, the budget request reflects a prudent and forward-leaning approach to fulfilling the Treasury Department's core responsibilities to support our economy, managing the government's finances and ensuring financial system security. I thank you for your past support and consideration of our work, and look forward to working with you during your deliberations.

Thank you and I welcome your questions.

Senator DURBIN. Thanks, Mr. Secretary, and I welcome my ranking member, Senator Brownback, of Kansas.

If you have an opening statement, I'll defer to you at this point.

Senator BROWNBACK. I'll just make some of those comments during my questions, I think that would probably be the best, prudent way.

If I could, Mr. Chairman, I'd ask if I could put my full statement in the record, right now.

Senator DURBIN. Without objection.

[The statement follows:]

PREPARED STATEMENT OF SENATOR SAM BROWNBACK

Good afternoon. At this first hearing of our subcommittee, I want to thank you, Chairman Durbin, for your leadership. I look forward to working together with you during this coming year as we make funding decisions and provide oversight to the various agencies within this subcommittee's jurisdiction.

Secretary Paulson, thank you for appearing before our subcommittee today. I look forward to hearing the details of your fiscal year 2009 budget request and the key efforts that your department will be undertaking this year. You have a crucial role in overseeing our financial systems and in promoting our participation in the international economy so I am interested in hearing your thoughts on the domestic and global economic situation.

Looking at the President's budget, I am pleased that it assumes the continuation of the President's tax cuts, which are key to preventing recession and allowing our economy to rebound from the sub-prime mortgage crisis. I am encouraged that the President's budget projects a balanced budget by 2012.

Mr. Secretary, regarding the economic stimulus package, I support the tax rebates to families and the expensing and depreciation changes to assist businesses. But I believe that we must look down the road at other ways to stave off recession, such as enacting incentives for U.S. companies to bring money back to this country from abroad. This would allow multi-national corporations to bring funds into the United States at a reduced tax rate for a period of time. I believe that we must continue to be proactive to keep our economy healthy. The most effective way to do this is to lower taxes so that consumers and businesses have more of their own money to spend and invest.

Mr. Secretary, the lion's share of your budget—approximately 90 percent—is for the Internal Revenue Service. I understand that you are seeking additional resources to close the so-called "tax gap." Certainly, we must ensure that taxes which are owed are collected. However, I remain concerned that our tax system is overly complex, complicated, and burdensome. Americans spend roughly $157 billion each year in tax preparation to ensure they do not run afoul of the IRS. The system is desperately in need of reform. One reason we have a "tax gap" may be that our tax system is so complex that taxpayers cannot figure out what they owe.

Mr. Secretary, I want to commend your Department for its efforts to combat terrorism. Your "Office of Terrorism and Financial Intelligence" is working hard to safeguard the financial system against illicit activities and combating rogue nations, terrorist facilitators, money launderers, drug kingpins, and other national security threats. This is important work and I am supportive of your efforts in this area.

I know that the Treasury Department is aggressively blocking U.S. commercial bank transactions connected to the government of Sudan, including those involving oil revenues. I am pleased that you are taking these actions. Last year, we passed legislation and the President signed into law the authority for your Department to levy greater criminal and civil penalties for those who violate these sanctions. I hope this new authority has acted as a strong deterrent for bad behavior.

Mr. Secretary, I am deeply concerned that American consumers are unwittingly purchasing products that have been manufactured with natural resources extracted by enslaved and abused children in countries where the profits are then used to support murdering and raping rebels. For example, I believe that our demand for coltan—which is an essential mineral needed for the manufacture of cell phones, TVs, and computers—has helped to fuel the conflict in the Congo. We need to be vigilant to ensure that American manufacturers are not supporting the conflict in the Congo by purchasing coltan. I would like you to work with us and perhaps the SEC to prevent American companies from purchasing coltan that has been mined by children and whose profits are supporting killings in the Congo. Congo's "conflict coltan" has created a vast and grave humanitarian crisis where 5.4 million people have died since 1998 directly and indirectly from the conflict and where 1,500 people continue to die each and every day.

We cannot sit idly by while others suffer. We need to be responsible as a nation and as consumers. We must hold our suppliers accountable. I plan to introduce legislation to stop the exploitation of coltan, particularly in eastern Congo. I am working with leaders of non-governmental organizations who understand the situation as I write this bill.

Mr. Secretary, I would like to hear what your Department is doing to support a stable and growing global economy through initiatives with developing economies throughout the rest of Africa and Latin America. I would like to hear how you can help ensure that we are not complicit in illegal activities in Congo and the rest of the world.

So Mr. Secretary, I look forward to hearing your testimony this afternoon.

Thank you, Mr. Chairman.

HOPE NOW ALLIANCE

Senator DURBIN. Mr. Secretary, the Treasury Department reported Monday that loan modifications under Hope Now helped 45,000 borrowers in January. But that number, as I understand it, includes all modifications of any sort, including those that only temporarily delayed foreclosure, rather than only counting mortgage changes that would allow families to stay in their homes for a longer period of time.

Isn't it true that Hope Now numbers you're citing include all mortgage changes of any sort?

Secretary PAULSON. Yes sir, very much.

And let me say that with Hope Now, the objective is—and the numbers you were citing have to do with subprime mortgage holders who were facing resets. And a major objective there is to help those homeowners who were facing resets they couldn't afford, and help them stay in their homes, and modifications to change the terms and to change, you know, the terms on a mortgage that lets someone stay in their home, is what we're about doing.

The other thing I would point out is that we're very fortunate in the—to the extent that the rate cuts that the Federal Reserve had made, made the impact of the some of the resets much less severe. And prior to the rate cuts, some of the initial resets were going to take the rates from 8.5 percent to 10.8 percent. After the rate cuts, they, you know, the impact was more like 8.5 to 9 percent. So, again, we received help there. And I certainly don't discount modifications that mortgage servicers made to let people remain in their homes.

Senator DURBIN. Are you satisfied that the financial institutions across America have responded voluntarily to the administration's request, in an adequate way, to deal with the current mortgage foreclosure crisis?

Secretary PAULSON. The way I would answer that question is I'm gratified by the progress that's been made, to date. And again, there's been some criticism, but in terms of an initiative that's up and going, I happen to believe it stacks up well, relative to anything else I see out there.

So, I would start off by saying that there's been 1 million people helped, to date, and I don't discount that at all, I think it's significant.

Now, the objective here—and I want to put this in perspective—that what we have is an industrywide effort in looking at subprime mortgages, where we have servicers covering 90 percent of the market. There are varying degrees of aggressiveness and sophistication in that group. And there are some firms in that group that didn't even need Hope Now to be doing the right things. And they've been out and they've been leading, and I thank them.

There are other servicers in that group that has less sophistication, were less prepared, we had significant obstacles—legal obstacles, accounting obstacles—we had the Securities and Exchange Commission (SEC) sign off on some accounting guidance on January 8, and technological issues.

So, the way I look at it right now is, we have some leaders, we have some followers, we have now—the followers fully implementing the protocol, and we have them doing that ahead of the biggest period of recess——

Senator DURBIN. Let me try to narrow it down, because I want to get to the point of understanding this. When you talked about 1 million borrowers being helped——

Secretary PAULSON. Yes.

Senator DURBIN. And that you're satisfied with some responses—I'm trying to put the response level, or the response so far, I should say, in the context of the challenge that we face.

Secretary PAULSON. Right.

Senator DURBIN. And I have heard that some 2.2 million—at least that's a common figure—mortgage holders in America—subprime mortgage holders—face the probability, possibility of foreclosure.

Secretary PAULSON. Right.

SUBPRIME BORROWERS

Senator DURBIN. I don't know if that's an accepted figure or an accepted estimate, but I've heard it repeatedly.

So, what do you think, what would—how would you describe, in percentage terms——

Secretary PAULSON. Right.

Senator DURBIN. The number of those vulnerable homeowners who have been helped, to date——

Secretary PAULSON. Right.

Senator DURBIN. By the administration's programs?

Secretary PAULSON. Well, let me say—first of all, let me deal with numbers. And if you give me a minute or two on this, we'll go through it.

That in a average, good year, you know, if we looked at 2002 through 2005, there are 650,000 foreclosures. Last year, estimates are there will be about 1.5 million. Some people are projecting 2 million foreclosures this year.

Now, I think, you sir, Mr. Chairman, are right to focus on subprime because if we look at the third quarter of last year, we had roughly 13 percent of these 55 million mortgages are subprime mortgage—they were——

Senator DURBIN. The 55 million mortgages?

Secretary PAULSON [continuing]. 55 million mortgages, 13 percent were subprime.

Senator DURBIN. That's of all the mortgages, you said, universal mortgages, 55 million?

Secretary PAULSON. All the mortgages, yes. And of that subprime universe, of that 13 percent, 50 percent of those were where we had foreclosures. And if you even look at a smaller sample, 6.5 percent were adjustable rate subprime mortgages, and they had 50 percent of the foreclosures.

And we had a—and on top of that—the 18 percent, if you take a look at sort of the—the period when there were the worst underwriting practices, which was 2006, and these so-called "2–28" mortgages, you know, teaser rate for the first 2 years, and then resets—that 18 percent of that pool foreclosed 6 months ahead of even the first reset.

So, again, as I look as the objective—and so, I think what's important, that we talk about what's a reasonable objective, and to me the reasonable objective is that every homeowner who is in a subprime mortgage and is able to afford the initial rates—because if they can't even afford the initial rates, I think there's a different problem we need to deal with—every homeowner that's in a subprime mortgage and is able to afford the initial rates, and can't afford the step-up rate, there should be a solution that keeps them out of foreclosure, if they are willing to talk to someone about it, and engage to talk about solutions.

So, a major issue we continue to have—and we're making progress—is that before Hope Now, that roughly 2 to 3 percent of those getting letters from servicers responded. Half of those going into foreclosure ever talked to anyone. Now the response rate is close to 20 percent—that still means 80 percent aren't having conversations.

Now, it's very hard for the Government or anyone, to help someone who won't try to help themselves, won't respond, won't engage in a conversation. There's also some people out there, where there's a different issue.

Just to step back, and the other issue that's out there, and you hear a lot of conversation about, is the put-out numbers, the 8.8 million homeowners that have mortgages that—where they have zero equity or negative equity in their home. Now, as you look at that universe, as I look at it, if you're a mortgage holder, even if you have negative equity in your home, if you can afford to make your mortgage payment, then I believe you've got an obligation to make the mortgage payment and you don't walk away—you're a speculator if you walk away because you happen to think your home is under water and the—your mortgage is under water. And I think most homeowners look at it this way—I think most homeowners, 93 percent of the homeowners are making their payment every month, you know, even if it's difficult for them to do so—only 2 percent are in foreclosure.

SPECULATORS

So, I do believe—but there are some, some of these, and they're doing terrible practices. Last year, even last year after all of this, 30 percent of the mortgages that remain in this country, there was almost no down payment or no down payment on a mortgage. And so, there are certain people that—sometimes they are second homes, they're speculators, they took out a mortgage, if the home value doesn't go up, they're walking away from that.

That's not the focus. The focus of our program is you've got to want to stay in your home, and respond to someone, and have the capability to do that. And I think on that—and just to finish up, Mr. Chairman—on that, we're continuing to make a very big effort, and I think the industry is, and we're going to monitor that very carefully.

Senator DURBIN. I've gone way over my time, and I want to give Senator Brownback his. But I do—I do want to go back to my question.

Secretary PAULSON. Right.

LOAN WORK OUTS

Senator DURBIN. You've really described the battleground, and the universe, but I want to zero in—how many of these have we helped? If, in fact, there are 13 percent of the 55 million that are subprime, that calculates out to about 7 million—if half of them are facing foreclosure, that's 3.5 million—how many have been reached by Hope Now, and this administration's efforts?

Secretary PAULSON. I would say, to date, okay, Hope Now, since the beginning there have been 1 million homeowners that have engaged in some form of modification or work out, okay? So, there have been 1 million people that have been helped.

But what we're not picking up in our numbers are the refinancings. So, even when you—the number you cited, I looked very carefully at that number, and there were 45,000 modifications, there were 167,000 work outs, both work outs and modifications went up faster than foreclosure starts—which was a positive. But we don't know the number of refinancings. And it's been hard, and there are a lot of refinancings. And so we will do everything we can to measure the numbers that have been helped.

The other thing I'm really focused on is, you can't help people that aren't going to help themselves, or reach out. The standard I really want to set is that if there's a homeowner, and has been able to make the reset, be able to make the initial payment, and they said, "I reached out and I talked to my servicer, and I'm still put into foreclosure," I want to know about that, because again, I want to follow-up. I mean, that's, to me, another—and we're going to work to get the numbers to help answer more and more of your question.

Senator DURBIN. I have some more questions, but I want to defer to my colleague, here.

Senator Brownback.

Senator BROWNBACK. Thanks, Mr. Chairman.

Secretary, thanks for being here. And also, just at the outset, I wanted to thank you for your years of expertise that you bring into the Government. I think particularly at this time with the economic problems we're facing, it's great to have somebody with your background and expertise, and I appreciate it.

Now, I'm going to yell at you, but I first want to tell you how appreciative I am, of you being in Government with this, because I think it does bring a stature that's needed, and it's very helpful to have.

I want to talk about two things—the economy, and terrorist financing. And I appreciate your describing the universe of the home situation, I wanted to describe a philosophy and then ask you questions on how to implement that.

I've been through a similar crisis in the past, my guess is you've also seen a couple of things like this, and so you bring a philosophy that's based on your experience, as well.

I went through the farm crisis of the 1980s, I was a lawyer in an undistinguished practice in the Midwest, and then went on to be agriculture secretary in the State. One of the things I saw in that early 1980s farm crisis—this would have been a Dick statement, Bigway, as well—is we took a crisis and we made it a huge—we took a problem and we made it a crisis. And we did that through trying to get too much done too fast.

There was land that went on the market at a cheap rate, and then—I was representing some farmers and some banks. The regulators came out and told the banks, "Clean up your loans," the banks went out and started suing a bunch of farmers to get their land, so we dropped a whole bunch of land on the market, a whole bunch of equipment, everybody's prices fell a huge amount, and it just exacerbated the problem—we tried to do too much, too fast, and we made it really bad. It was bad.

So, I take that experience and I say that the thing we need to do now, because we've got a real problem here, is we've got to string this out, over a period of time, and not try to see too much housing stock get on the market too fast. Because if you get too much out there, you further plummet, and you get a whole bunch more people that are in trouble.

So, if that's the correct philosophy, we need to meter this out over a period of time. We've got a problem, we had excess capital, or problems coming in, and bad loans taking place, and sharks out there, and we've got to work our way through this.

Is the way to do that not just what the administration is proposing, but also tax credits for purchasing housing or even distressed housing? Or, some people are proposing changes in the bankruptcy code, to provide for a cram-down feature on housing? If you agree with the philosophy, I would like for you to say which actions by Congress you think would be the appropriate ones to prevent this problem from making an even worse impact on the overall economy.

CAPITAL MARKETS

Secretary PAULSON. Right, Senator, I assume since there's just the two of you, I can take a little bit longer time, since I took a lot of time on the chairman's question.

Senator BROWNBACK. Fine.

Secretary PAULSON. Because it's a very good question and I think it deserves a thoughtful answer, and I've thought a lot about it.

The, first of all, I've said for some time, that as we look at this crisis, there's two focuses. First and foremost is getting through this period with as little impact—negative impact—as possible on the real economy, and so second, is what's the policy response to reduce the likelihood of going through this period again, something like this? And so we don't want to do something up front that's going to compound the problem in the short term, or to make it worse in the longer term.

Now, there are a number of—even before you get to the housing, that is why I have been, when we look at what's going on with the capital markets turmoil right now, that I have been so focused on having all of our financial institutions, including the GSEs, raise capital that they need, so that they can be active in, you know, in the market—lending, keeping up their normal economic activities, as opposed to shrinking their balance sheet.

Now, in looking at housing as I've looked at this, and I've looked at a whole lot of things, first I focused on efforts that would avoid what I would call a market failure. And the level of adjustable rate mortgage resets that were coming is such a wave that it wouldn't allow the private sector to react the way they normally would react, which would be to have the investor have time to strike a deal with each individual mortgage holder, and work something out that was in both of their best interest, because foreclosures are costly. And so that's why this ASF protocol, and working the fast-track modifications, to avoid avoidable foreclosures.

The other big effort we still have—we have a number of things that have been done, are when you look at Fannie Mae and Freddie Mac, that we have them today to go back far enough in our history, we didn't, and they can play a constructive, counter-cyclical role. And they have been, but to continue to do so, they're going to have to raise more capital, and be very active there.

Senator BROWNBACK. What about tax credits and bankruptcy reform?

BANKRUPTCY

Secretary PAULSON. Oh, yeah, I would say this now, let me get at both of those. In terms of bankruptcy reform, I've had some very good conversations with your chairman, and he and I have a very similar objective. We approach this differently, and there's two reasons why I don't like the bankruptcy reform. First, as a matter of property rights and contract, I don't like the idea of retroactively changing contracts, and I'm concerned with what it might do to financing availability going forward.

But even more importantly in working through this, I am emphasizing a program which says, if you're a homeowner, and you want to stay in your home, and you can afford to stay in your home—raise your hand. Call, reach out to someone. And it's a lot quicker than slowing it down, and bogging down our courts.

Senator BROWNBACK. What about the tax credit ground?

TAX CREDITS

Secretary PAULSON. Yeah, I think the, you know, the tax credit, I understand the concept very well, because we're looking at it—the overhang, and the inventory of unsold homes. I think that what you're apt to get with that is something that's going to prolong the issue. And so, net-net—although I look at it as a creative idea, there have been some creative ideas—we are much more focused right now, and let's get the GSE reform, get the Federal Housing Administration (FHA) modernization done, get the tax-exempt financing done, and so we're not there on the tax credit. But, again, I understand what people are seeking to get at with that proposal.

CONFLICT MINERALS

Senator BROWNBACK. If I could just ask one more question in the length of time we have. I've handed you a proposal, this is on financing—terrorist financing, and also conflict commodities financing, I think it's a topic you—the administration has done a pretty good job of trying to get at—terrorist financing.

I want to put another issue in your portfolio, and it's conflict commodities in Africa, particularly from the Sudan and Congo.

Secretary PAULSON. Yes.

Senator BROWNBACK. And that we really start targeting these commodities coming out of conflicts so as to prevent further exacerbation of the conflict.

Secretary PAULSON. Yes.

Senator BROWNBACK. Senator Durbin and I went to Congo together, I've even got a picture of one of the coltan coming out of Congo, financing it, now tin is being used—these are kind of Mom and Pop mining operations.

Secretary PAULSON. Yes.

Senator BROWNBACK. This is kind of how they mine coltan that's in your cell phone, or even tin out of Congo, this picture is taken out of Congo. No other group—they've got a proposal out of a draft piece of legislation saying that we won't purchase commodities from conflict zones, where that money is used to finance rebel groups.

I would urge you to look at it, because I think this going to be one of the keys for us to try to stabilize Africa.

Secretary PAULSON. Yes.

Senator BROWNBACK. We need to keep the money from going to these rebel groups, particularly like in the eastern Congo, it's a classic place. I think it's also what we need to look at in the Sudan.

Secretary PAULSON. Yes.

Senator BROWNBACK. There you've got a government that's being primarily financed by oil and I think we need to be very aggressive on this in looking at it.

And I would draw to your attention to one other thing, that we have done, Senator Durbin and a number of others worked on the Sudan Divestment Act that passed. I'd like to see us do a similar one on Iran, as a way to divest and get money out of the financing of the conflicts.

I draw that one more to your attention than for a response, unless you give me a positive response, you don't need to respond at all.

Secretary PAULSON. How could I not be positive? Because this is a real problem, and your leadership and the chairman's leadership are very much appreciated on this. And I will pass on the comments to Secretary Rice and others at the State Department, because I think this is something that I know is an important issue.

Senator BROWNBACK. Thank you.

Senator DURBIN. Senator Allard.

Senator ALLARD. Thank you, Mr. Chairman, thank you for holding the hearing to examine the budget request for the Treasury Department.

And it's a pleasure to be here, to be able to welcome you, Secretary Paulson. We have an opportunity to see one another quite frequently——

Secretary PAULSON. Yes.

COSTS OF COINS

Senator ALLARD. And so I do appreciate the job that you're doing and I apologize for being—not being able to be here to hear your testimony this afternoon, we started markup on the budget—we started debating the budget, and so, I'm on the Budget Committee, so it's important that I at least be there for the opening part of the Budget Committee debate.

I did want to stop by briefly to raise one issue which has important appropriations implications, and I appreciate my colleagues accommodating my schedule on this.

Last week on a radio program, you'd advocated for the elimination of the penny, but added that you didn't think it was politically doable.

Secretary PAULSON. I didn't——

Senator ALLARD. If my information is correct.

Secretary PAULSON. No, I did not advocate it. I've got no intent, no plans to advocate it. What we're advocating, though, very strongly, for is we have legislation that would change the content of the——

Senator ALLARD. Well, that's what I'm getting at.

Secretary PAULSON. The penny and the nickel.

Senator ALLARD. Yeah.

Secretary PAULSON. Which would save the American taxpayer a good bit of money.

Senator ALLARD. Okay. This was an Associated Press story. They must have got that wrong in the story.

Secretary PAULSON. Yeah, I said—what I had—we have no intent or plans to——

Senator ALLARD. Well, we can still move forward with my question.

Secretary PAULSON. Right.

Senator ALLARD. Because I've introduced legislation, I believe we've got bipartisan support on this, S. 1968, which gives the flexibility to the Treasury Department to manage the content of the coin.

Secretary PAULSON. Right.

Senator ALLARD. Metal content. So, my question is, is—how much do you think this could save, as far as the Treasury Department is concerned, and how urgent do you think it is that we get this changed, to give you the flexibility with the changing metal market. You know, gold right now is at a historic high, I think, and a lot of our metals are falling right in behind that.

Secretary PAULSON. Yeah, it is, you know, we're losing money for every penny we mint and——

Senator ALLARD. Even a nickel, too, right?

Secretary PAULSON. I don't have the number offhand—oh, the nickel's even more. It's—I think the nickel—directionally right, if it's, it costs 7.7 cents or something, to make a nickel or 1.4 cents to make a penny, and I'll get you the numbers.

[The information follows:]

COST OF PENNIES AND NICKELS

Using current metal prices (February 2008), production costs this year for the Mint will be more than 1.3 cents per penny and 7.7 cents per nickel.

Secretary PAULSON. But, when I looked at it over the period of time, we're talking about hundreds of millions of dollars.

But, whatever the number is, there's no reason to be losing money in a needless way. And so we just need to change the metal content of those coins.

METAL CONTENT OF COINS

Senator ALLARD. Well, you know, and I sympathize with—given you and the various agencies that you work with, the flexibility to change that metal content. Because, you know, all of these metals—they change in value from year to year, and I don't think the action of the Congress can keep up with it, and if we can do this in a way that saves taxpayer dollars——

Secretary PAULSON. Right.

Senator ALLARD [continuing]. I think we ought to do it. And the sooner the better. And so anything you can do on that to help us get the message out, we'd appreciate it. I do think it's a very commonsense kind of piece of legislation, and something that I think we need to do.

Secretary PAULSON. It is. It is, very much.

Senator ALLARD. So, anything you can do on that, we'd appreciate it.

And you know, I—I guess the question is, are there metals that we would use that—we potentially could use—that we're not using now?

Secretary PAULSON. Yes.

Senator ALLARD. Yes.

Secretary PAULSON. They are—they're composites, and there's been a lot of work done on this.

Senator ALLARD. Is that right?

Secretary PAULSON. And I'd be very happy to send some people up to give you all the details on it, because there's been a lot of good work done on this by the Mint.

Senator ALLARD. I would appreciate us being briefed on that, if you would, please. And maybe other members of the subcommittee would be interested in that.

Secretary PAULSON. Go through the whole economic analysis.

Senator ALLARD. Okay, well, very good, well I'd like to follow-up on that a little bit, and maybe we can all get that information, get briefed together, or something. I don't know if we need to have a formal hearing on it, Mr. Chairman, but if you wanted to include it or something for the members of the subcommittee, we could do that. But, I'm particularly interested in it, and would like to have that information.

Thank you.

Senator DURBIN. I thank the Senator from Colorado, and just for the record the Lincoln penny was initiated 100 years ago, on the 100th anniversary of Lincoln's birth. And the bicentennial of that birth, next year, will result in four new backs for the penny to show different aspects of Lincoln's life. And the metal content is secondary to the people of Illinois, as long as Lincoln's on the penny.

Secretary PAULSON. But, we can do them both, right?

Senator DURBIN. Right, no objection.

Secretary PAULSON. We can do them both, and we celebrate it.

Senator DURBIN. Yes.

BANKRUPTCY

Mr. Secretary, Federal Reserve Chairman Bernanke recently said, relative to the foreclosure crisis, "Principal reductions that restore some equity for the homeowner may be a relatively more effective means of avoiding delinquencies and foreclosure." And he continued, "When the mortgage is under water, a reduction in principal may increase the expected payoff to the bank by reducing the risk of default and foreclosure."

I want to say a word about the bankruptcy provision which you've alluded to, because Senator Brownback will get a chance to consider that measure in a day or two in our Senate Judiciary Committee.

Over the months since we've first initiated the concept, we have changed it dramatically. Originally, we said that there was no equity or justice in allowing a bankruptcy court to modify the terms of a mortgage on a vacation condo, a farm or a ranch, but to prohibit, by law, any modification of the terms of a mortgage on a principal residence or a home. And so, initially, we began with the premise, let's treat them all the same, allow the bankruptcy court that option.

But, some have observed that that may have a negative impact, so we have dramatically restricted the bankruptcy reform that I am proposing. First, it's harder to get into bankruptcy court today than it was 5 years ago. You have chapter 13, which requires certain requirements, income requirements and the like, before you can end up in the bankruptcy court.

Second, we restricted this provision, this change, only to homeowners, so no speculators need apply. You have to actually live in the home we're talking about.

Third, we said only subprime mortgages for those homes.

Fourth, we said that any modification of the terms of the mortgage could not reduce the principal any lower than fair market value to protect—as best we can—the lender who, if they're facing a distress sale, are lucky to see fair market value.

Then we said the interest rate has to be based on the prime rate plus a reasonable premium for risk. And, we added another provision which, I think, is an effort to go an extra mile to win back some support from the banking community, and it did win the support of credit unions. If there is a modification of the principal on a mortgage in a bankruptcy facing foreclosure, and say a house is re-valued from $500,000 to $450,000, and then in subsequent years, increases in value, back up over $450,000—that delta, that change, that improvement—will go to the lender. So, we're trying to protect the lender on the downside fair market value and the upside, in terms of appreciation.

What I'm troubled with is this reference by yourself and bankers to the "sanctity of the contract." I've seen some of these contracts in our home State. There's nothing holy about how these contracts were entered into. Many of them were deception at its worst. People were taken advantage of. Poor people, uneducated people, senior citizens.

And to hold these as "holy instruments" which now must be respected, overlooks the obvious—when we changed the bankruptcy code 5 years ago, we changed the impact of all of the contracts that come in under bankruptcy. The sanctity of the contract was never raised by the banks who wanted to change the bankruptcy code for their advantage.

Now, when they may end up negotiating a contract of mortgage which they've resisted negotiating, they're arguing the sanctity, the "holiness" of the integrity of this contract. And I will tell you, I can give you chapter and verse of some that were as unholy as you can imagine.

Secretary PAULSON. Can I respond to that?

Senator DURBIN. Of course.

Secretary PAULSON. Because there is no way you're ever going to get me defending some of those loans. And I am cheering on our law enforcement agencies, everyone that is going after the fraud.

What I was talking about was taking a bankruptcy statute, that was designed the way it was for a reason. The presumption is the judge is going to—you're not going to be altering the terms of a vacation home or a sailboat, or whatever. You're in bankruptcy, the presumption is, you lose it.

Senator DURBIN. Not in chapter 13.

Secretary PAULSON. It's——

Senator DURBIN. Not in chapter 13.

Secretary PAULSON. But, I'll tell you, it's a much different presumption when you're talking about your home. But again, rather than—I just make two points, okay? And I'll just make them again, and make them quickly. That, to me when you change a bankruptcy statute and do it retroactively—I recognize you've narrowed it, okay?—to change it retroactively, it's something that gives me pause. And then second, again, that when you look at bogging down the system and dumping this in the courts when I think a simpler, more effective way to deal with it is to have homeowners when there's a problem, go deal with it.

And a large number of foreclosures we're seeing, from everything I can learn, is homeowners not responding.

Senator DURBIN. But, Mr. Secretary, let me tell you, you said that earlier. "If you can make the original payment and can't make the reset, hold up your hand," you said. Well, you've got hundreds of thousands of borrowers across America who are in this predicament, and to say to them, "You should go take care of your problem."

What I'm saying to you is, the response so far, the voluntary response of your administration programs has reached some, but not nearly enough to turn this crisis. The Fed—the Chairman of the Federal Reserve, Mr. Bernanke, is basically said what I am saying. That there comes a moment in time, that if you want to turn this crisis, you have to deal with the reality.

I don't want these people to go to bankruptcy court—if I could just finish—I don't want these people to end up in bankruptcy court. But if the lender understands that there is a possibility of bankruptcy and modification, they are much more likely to renegotiate the terms of the mortgage before bankruptcy. Currently, there is no incentive.

Secretary PAULSON. Listen, I very much appreciate what you're trying to do and your motives, you appreciate mine. As far as I know, Ben Bernanke is not advocating changing the bankruptcy law retroactively. And again, there's a fact, and the fact is that we're making a huge effort. There still are a fair number of people that—a large number of people, a disappointing number of people—aren't responding when they get numerous letters and phone calls and they hear—and all I'm saying is, wouldn't it be easier to—and how do you help someone if they're not going to raise their hand and——

COUNSELING FUNDING

Senator DURBIN. Then let me ask you this question, why did the administration issue a statement saying that they would veto the housing stimulus bill before the Senate last week, and one of the reasons because it would have substantially increased the number of counselors available for those facing foreclosure. If your argument is that enough people aren't seeking help, why did the administration say that that was one of the specific reasons they would veto the housing stimulus bill?

Secretary PAULSON. Well, I missed that part of it, because I will tell you that counseling is vital. And one of the things that the administration has been advocating has been funding for counseling, and funding a counseling partially by the servicers at Hope Now, and the whole effort. And the 888–995–HOPE number is to get people to call and get to counseling.

So, you know, I didn't read that part that you're referring to, but I sure know that the—we've got a similar objective and I appreciate the fact that you've narrowed it appreciably, and again, I'm just giving you my——

Senator DURBIN. Senator Brownback.

LOAN WORK OUTS

Senator BROWNBACK. Thank you, and this is a good discussion, because I remember the same discussion during the farm crisis time period. And, a lot of these loans need to be restructured.

Is it your belief that a number of the loans that people want to restructure are being restructured by financial institutions?

Secretary PAULSON. I sure believe that.

Senator BROWNBACK. Do you have any hard numbers that you've been able to track or to look at?

Secretary PAULSON. What we've got—here's some hard numbers I've got. Some are encouraging and some are discouraging.

That, before this effort, 2 to 3 percent of the people were responding to servicers, when they went to homeowners that were facing resets or delinquent. Now, 20 percent are responding, okay? So, that's a positive.

We have a hard number that since the beginning of putting this together, that there have been 1 million homeowners who have been helped—either, you know, through a, through a work out of some sort.

We have hard numbers that this last—the last month, that I was encouraged to see modifications and work outs growing faster than foreclosure starts. But, I don't have numbers on refinancings.

Part of the problem we have, Senator, is that—as I said earlier, there are really—and the chairman made that point—there were just egregious, some of the lending contracts and some of the way people were put in these loans, and there—but there were 18 percent of the 2006 adjustable rate subprime mortgage holders defaulted 6 months before the first reset. They couldn't afford the initial payment.

And so, there are, regrettably, going to be some people that are going to return to becoming renters. But, again, I'm going to work hard to make the Hope Now Alliance work, and work better, we're going to work as hard as we know how to get the data out there and to track it, and I've got to tell you, if something isn't working the way it needs to work, then we're open—and I'm sure open—to making modifications in the way we approach things. We just have a——

Senator BROWNBACK. Secretary, if I could, and I just wanted to interject, and I appreciate you going through this—my raw point on this would be that I really hope that the financial institutions and the administration can make the work outs work.

Secretary PAULSON. Yes.

Senator BROWNBACK. Because if it looks like things aren't working or that the financial industry says, "Look, we're just going to dig in and start fighting on these," then I think the issue comes back in front of the Congress at that point in time.

So, I think there is a period where people can look at this, and say, "You know, the bank doesn't want the home back," the financial institution doesn't want the home—they want the person to stay in it.

But, a lot of times, people have gotten into something they shouldn't have, or were talked into something that they shouldn't have been. We are where we are today, and we all know we've got a problem here, and I just think if we can make the work outs work in substantial numbers across the country, then great. I would presume, really, Senator Durbin would be very happy with that.

If they don't, then it becomes a more difficult matter if these numbers start jumping up. And that would be the point I would like to make to you, on a raw basis.

Secretary PAULSON. Senator, can I respond to that in one way? Because no matter how well we make this program work, given the excesses that were entered into, the foreclosures will jump up. And there are a number of homeowners who were speculators. There were a number of homeowners in hot markets that put very little down, the first time there's some negative equity from their home, they're going to walk away from their obligation.

And I think the very interesting question there—to me, it's not a difficult question, for some it's a more difficult question, to me it isn't—that if someone is going to walk away unless someone else pays for their losses, I don't want it to be the Government or other taxpayers to pay for their losses. To me, those are speculators, and that shouldn't be the focus of our efforts.

Senator BROWNBACK. Fair enough.

Secretary PAULSON. And so, when you look at these foreclosures, I'm focused on the same ones that Chairman Durbin is focused on—in other words, homeowners that want to stay in their home and are having trouble with——

REPATRIATION OF FUNDS

Senator BROWNBACK. I want to build off of that point with the little bit of time that I have here. It certainly strikes me that one of the biggest things we all want to avoid is this soft economy going on into a recession. The economy's soft, credit's tight, and we don't want it to slide on into a recession. I think the administration is trying to do everything they can to stave off a recession.

One of the issues that I want to draw to your attention—I'm sure you've looked at this—is repatriation of funds from large corporations bringing back to the U.S. economy. Last time we did that, that brought in $284 billion in earnings from overseas back into the U.S. economy in a 1-year time period, where normally we'd have about $70 billion in the same 1-year time period. So, nearly a $200 billion infusion into the U.S. economy. I hope the administration would look at something like that as an infusion of cash into the economy, which we need to have at this point in time.

Secretary PAULSON. Senator, I thank you for pointing that out. It's something we've looked at, it's something that I had calls from a number of people I knew in the private sector advocating very hard for that at the time we did the stimulus package. And since we were very rigorous on the stimulus, in terms of saying, "Everything that went in had to be stimulus," there are some things that are very good economic policies, and, you know, I knew from a lot of experience, just because a company brings cash back, doesn't mean they're going to spend it, okay? And so, we focused much more on things that were going to increase the likelihood that it'll be a real stimulus.

But, I understand the incentives and motivations you're talking about, and the wisdom of something like that, and I thank you for bringing it.

Senator BROWNBACK. Well, it strikes me that we may be getting to a point where we want to put everything out there we possibly can to keep the economy from going into recession. And even if the corporations don't spend it, if it's sitting overseas, they're for sure not going to spend it here.

Secretary PAULSON. Right.

Senator BROWNBACK. You've assured that one of taking place.

So, I think we ought to be looking at the next step on this, just to——

Secretary PAULSON. Right.

Senator BROWNBACK [continuing]. Because things are tough out there, and it looks like, it's going to be difficult for the consumer to come back in the marketplace, to the degree or level that we want. So that's going to depend upon a lot of corporations and individuals investing, us being very competitive with our exports—which have grown substantially.

Secretary PAULSON. Yes.

Senator BROWNBACK. Us expanding the energy industry domestically, I just think now we're looking at some bit of restructuring of our economy, probably a little away from the consumer, and more towards exports, energy—and these are great opportunities for us. I see you put some things on the energy market, here, I hope we can do that.

ALTERNATIVE METALS FOR COINS

And just a final comment—I just hope you don't make the penny out of plastic, or nickel out of plastic. Make it out of some metal.

Secretary PAULSON. Yeah, we're talking about composite metals, right, we're just changing the metal content a bit.

Senator BROWNBACK. All right, thank you. Unless it's wheat-based plastics or something like that.

You know, maybe corn, being from Illinois, but just—don't make it out of plastic.

COUNSELING FUNDING

Senator DURBIN. We have a bipartisan position on that.

Mr. Secretary, when you get back, take a look at the statement of administration policy issued February 26, this year, relative to the housing stimulus bill on the floor, and you'll see that the administration said that it would veto this bill over the suggestion of tripling the funding for the Neighborhood Reinvestment Corporation, which was expressly for more counselors.

Secretary PAULSON. Yeah, I just put in front of me, yeah. You said it's because—I think the view is we've got plenty of funding right now.

Senator DURBIN. Well, I think that—I've been out, locally in Chicago and all around our State, and I think that's arguable. Because if we are reaching 20 percent, and still have 80 percent, some of that is because of lack of volition on the part of the borrower, but it appears to me that there's a lot more that needs to be done if there's truly going to be an aggressive approach to this.

I would just like to close, and I'm going to give you a chance to respond, because it's—what I'm about to say is critical, and I want to hear your response to it.

When one of your senior counselors was asked yesterday about the Treasury Department report on loan modifications under Hope Now, 45,000 borrowers in January, the senior mortgage banker who runs the Hope Now program said, and I quote, "A mortgage servicers obligation is to get the maximum value to the investor over the life of loan. If you're going to modify the loan and keep the borrower in the house, the bias is to do that for a shorter, rather than a longer, period of time. There's a reluctance to do long-term modifications."

So, I think the 45,000 figure may be misleading. If it's only temporarily suspending the foreclosure, it's not going to help in terms of really trying to right this ship.

My concern from the beginning, is that I know the administration's philosophy, that you have carried out, calls for voluntary involvement by lending institutions. When we suggest bringing in a bankruptcy court to try to force the hand of some of these banks to finally renegotiate, the administration opposes it, and says they'll veto a bill.

I have said, repeatedly, and I won't go into the graphic detail, I don't think that the response to this housing crisis is adequate. I think it is going to continue to get worse. And as long as it worsens, and as long as the housing industry is in such terrible shape across America, it's going to be hard to see a sound economic recovery.

It isn't just the builders, and the speculators, and the land developers, it's all the material men and skilled craftsmen and everyone else who are, frankly, not doing much work in my State of Illinois and around this country, waiting for the housing market to come back. And those of us who own homes are watching the values go down because of foreclosures. And we're watching units of local government that will face serious problems as assessed valuation goes down, and as property tax revenue goes down that's used to sustain local units of government.

If there was ever a time for someone to push away a Herbert Hoover view of this, and say, "We need a New Deal view of this, that says there has to be something that's decisive, and meaningful, and reaches the most number of people as quickly as possible to turn this ship around," I think it's now. And the longer we wait, the worse, I think, it's going to get.

And, I invite your response.

Secretary PAULSON. Well, let me respond to that, and the counseling.

I would say on counseling, I get out a fair amount, and spend time with counselors, I'll be spending some time when I'm out in California later this week, when I was in Chicago, I spent time with NeighborWorks. And at least to date, when I've talked with counseling firms, they're not impeded by a lack of funds, okay?

There's not—and so we're, because I just don't want there to be a difference between us on that. Because this is essential and it is, it's major.

LOAN MODIFICATIONS

Now, in terms of modifications, various firms take various approaches to the modification. But to me, the focus I have is having mortgage servicers make modifications that help people stay in their home, and avoid foreclosure. And that is the objective, it is—I think these are costly things to go through, I don't think it's in the interest of either the borrower or the lender, to have something not be sustainable. All I can say to you is that on that effort, I'm going to drive that as hard as I know how.

Now, in terms of your overall comment, where you talked about Herbert Hoover—there's been a lot that's changed since we went through the Depression and when the foreclosures were 50 percent and unemployment was 25 percent. We have GSEs, we have the FHA, we have the Federal Home Loan Banks, that we're going through a period now where 93 percent of the people in this country, every single month, no matter how hard it is, make their mortgage payment. Two percent—not 50 percent—are in foreclosure.

Now, I believe when you say you think it's going to get worse, I'm not arguing with you. I've said that I think that those forecasters who say that this is an adjustment, a period of adjustment, it's going to take longer to run its course—I agree with them.

You know, when I look at the mortgages that were made in 2006, that are going to be reset over the next couple of years, and when I look at some of the mortgages, the negative amortization mortgages, which will be coming, now, even further out—I recognize that this is going to take longer. And again, I've told you where the focus is, and we're focusing very hard on avoiding preventable foreclosures to those who want to stay in their home, and have the capability to do that.

I appreciate you and I want to do the same thing. I'm going to keep watching this very closely, we're going to be all over it, and I, you know, as again, I know you've got the same objective I do. We've got some—and you're supportive of Hope Now, you're saying you think there should be some other things done——

Senator DURBIN. There should be more.

Secretary PAULSON. And we're just——

Senator DURBIN. Well, let me thank you for coming today and testifying—we didn't talk much about your budget. But you will get plenty of written questions on that, which we will submit to you.

Secretary PAULSON. Thank you.

ADDITIONAL COMMITTEE QUESTIONS

Senator DURBIN. And we will provide those for you. And any members who wish to make statements and allow them part of the record, they will be included, and any questions in writing, I ask that you try—I know you're a very busy man, but if you'd try to respond to them in a timely fashion, we would appreciate that very much.

[The following questions were not asked at the hearing, but were submitted to the Department for response subsequent to the hearing:]

QUESTIONS SUBMITTED BY SENATOR RICHARD J. DURBIN

TRADE

Question. In Illinois, we continue to see losses in manufacturing jobs that can at least in part be attributed to the forces of globalization. The Trade and Globalization Adjustment Assistance Act of 2007 extends Trade Adjustment Assistance (TAA) to services sector workers and workers affected by offshoring, creates a new TAA program for rural and distressed communities, and makes training, healthcare, and wage insurance benefits more accessible and flexible. Does the Administration support strengthening Trade Adjustment Assistance along these lines?

Answer. The Administration strongly supports TAA reauthorization that includes needed reforms to help workers adversely impacted by trade access the training and reemployment services they need to return to work quickly.

Reauthorization provides an opportunity to redesign the TAA program to make it more effective in enabling workers to gain the skills needed to successfully compete in the 21st century global economy.

The Administration believes there are several flaws in the TAA program as it is currently designed. These flaws include:

—TAA is an "all or nothing" program, where participants lose access to benefits by choosing to return to work.

—Training options are limited and the process of applying for training is lengthy and bureaucratic.

—Services cannot be provided until after the worker is laid off—even when the layoff is announced well in advance.

—There is no requirement that One-Stop Career Centers provide "wrap-around" services such as career counseling, assessment and job placement assistance to all TAA participants through the Workforce Investment Act (WIA).

The Administration believes any reauthorization of the TAA program should reflect the following priorities:

—Workers must have increased choice to combine employment with training and "earn while they learn."

—Training options should be flexible and easy to access.

—Services should be available prior to layoff, in order to reduce the length of time workers are unemployed.

—Integration with the Workforce Investment System should be improved by requiring states to ensure workers have access to the full range of services available through the One-Stop Career Centers under WIA.

Question. It is difficult for workers to complete some courses under the current TAA restrictions because it simply takes longer to finish the programs than TAA allows. For example, Illinois has an acute shortage of nurses, and yet the state is unable to find enough people either to teach the training courses or to complete the programs. This is a high-growth area for workers that cannot be readily outsourced. However, our TAA rules make it nearly impossible for displaced workers to enter the nursing profession because the program takes longer to complete that TAA allows for training. Do you support common sense updates to Trade Adjustment Assistance rules that would address difficulties like this?

Answer. The Administration believes that a high priority for TAA reauthorization is that trade-affected workers must have increased individual choice to "earn and learn" by having access to transitional benefits, such as education and training post-employment and transitional income support (in certain cases). Benefits under the program should include a menu of "New Economy Worker Services" that allows the worker to choose the option that best fits his or her individual needs. For example, training-related options should allow a worker to combine either full or part-time work with education and training. Similarly, the reauthorization would ensure greater access to education and training by providing "New Economy Scholarships" to workers that could be used over four years. Additional monies would also be available to workers who need pre-requisites for training in a high demand occupation. The New Economy Scholarship should be portable, enabling certified workers to have access to tuition assistance whether they are unemployed or return to employment. Workers should be able to choose to attend training full or part-time and use the funds for tuition, books, fees and required tools.

INTERNATIONAL SANCTIONS: SUDAN

Question. Does the Bush Administration intend to enforce the Sudan Accountability and Divestment Act, which I worked very hard to pass in conjunction with Chairman Dodd and Chairman Frank over in the House, along with the Ranking Member of this committee, Senator Brownback?

The Treasury Department will provide to Congress the reports called for in Section 10 of the Act. Section 6 of the Act governs the Executive Branch concerning government contracts with companies that conduct certain business operations in Sudan. The Treasury Department intends to comply with that provision once the Federal Acquisition Regulation is updated by the Federal Acquisition Regulatory Council, as provided for in the Act.

If so, why did the Administration issue a signing statement that left in doubt whether that would be the case? If not, why did President Bush sign the bill?

Answer. The Department respectfully recommends that these questions be directed to the White House.

INTERNATIONAL SANCTIONS: CUBA

Question. Do you think that the United States should view the transfer of power from Fidel Castro to his brother Raul as an opportunity to strengthen ties to Cuba? Or do you think our policies of sanctions and non-communication should continue? What benefits are derived from a stay-the-course, status-quo approach to Cuba that would maintain the policy of isolating the Cuban government with economic sanctions? Is any consideration being given to an approach aimed at influencing the Cuban government through an easing of sanctions and increased contact and engagement? If not, why not?

Answer. The United States foreign policy positions are defined by the State Department. The Office of Foreign Assets Control (OFAC) administers and enforces the country sanctions against Cuba, which restrict the flow of funds to Cuba that would otherwise be used to prop up the regime rather than benefit the Cuban people. The Administration's policy has been designed to prevent resources from reaching the regime, which uses its resources to control and oppress the Cuban people. We will continue to monitor developments closely and stand ready, if asked, to assist a genuine Cuban transition government committed to democracy.

REDUCTION IN REQUESTED CDFI FUNDING

Question. Compared to fiscal year 2008, proposed reductions could jeopardize $700 million in private capital for CDFIs that could otherwise be made available to communities and individuals currently facing credit shortages. Why are you recommending such a drastic reduction to a program that demonstrates such a tremendous return on the taxpayer's dollars?

Answer. The fiscal year 2009 President's budget includes over $28 million for the CDFI Fund, which will be used to expand the capacity of financial institutions to provide credit, capital and financial services to underserved populations and communities. Specifically, the CDFI Fund will continue to provide grants, loans and equity investments through the CDFI Program, allocate tax credits through the New Markets Tax Credit Program, and support the CDFI Fund's existing grantees.

The fiscal year 2009 President's budget does not propose funding for the Bank Enterprise Award (BEA) Program. The BEA Program provides funds to for-profit banks based on their past activity, and has not demonstrated that its awards increase lending and financial services in economically distressed communities. The BEA program is in the process of modifying the program's regulations. With these revisions in place, any future BEA funding will encourage future community development activities, rather than reward past activity. This change aligns BEA Program activities with the CDFI Fund's goals and objectives.

In fiscal year 2009 the CDFI Fund will continue to serve Native communities through the CDFI Program; however, the fiscal year 2009 President's budget does not include a separate request for Native Initiatives.

Question. How do you reconcile this proposed reduction with the Administration's concern with the shrinking availability of credit?

Answer. The Department of the Treasury encourages the availability of capital and credit to all communities, including low-income, through a broader system of financial institutions. While the CDFI Fund provides capital and credit to financial institutions serving low-income communities it is not the only source of funding available to these institutions. These intuitions may also receive funds from various federal, state, and local entities, such as the U.S. Department of Health and Human Services, U.S. Department of Agriculture, state economic development agencies, and local municipalities. Non-government funding sources for these financial institutions include banks, thrifts, credit unions, and non-regulated institutions such as loan funds and community development venture funds.

ECONOMIC STIMULUS REBATES

Question. I understand that you anticipate that IRS will begin sending rebate checks starting in May. When do you project that the payments will have a noticeable positive impact on the economy?

Answer. The first economic stimulus payments will be issued by direct deposit beginning May 2, 2008. The first paper checks will go out beginning May 16, following the schedule outlined below.

STIMULUS PAYMENT SCHEDULE FOR TAX RETURNS RECEIVED AND PROCESSED BY APRIL 15

Direct Deposit Payments	
If the last two digits of your Social Security number are:	Your economic stimulus payment deposit should be sent to your bank account by:
00–20	May 2
21–75	May 9
76–99	May 16
Paper Check	
If the last two digits of your Social Security number are:	Your check should be in the mail by:
00—09	May 16
10—18	May 23
19—25	May 30
26—38	June 6
39—51	June 13
52—63	June 20
64—75	June 27
76—87	July 4
88—99	July 11

Based on the payment schedule, the Department projects that the stimulus will begin to provide a meaningful boost to spending almost immediately and that its effect on economic growth will be felt through the rest of the year. The Department also anticipates that the individual and business tax relief components of the package together could lead to the creation of over half a million jobs by the end of the year.

NEW 24/7 OPERATIONS CENTER

Question. The President's 2009 budget for the department requests $6.2 million for a new Operations Center, which would provide 24/7 capability to monitor the global market. How will the enhanced capabilities of the new Operations Center support Treasury's mission?

Answer. The Department of the Treasury serves the American people and strengthens national security by managing the U.S. Government's finances effectively, promoting economic growth and stability, and ensuring the safety, soundness, and security of the United States and international financial systems.

The global scope of the Department's operations requires a 24/7 response capability. The Treasury Operations Center will act as a fusion center for the receipt, analysis, and dissemination of information critical to the economic well being of the country. It will have enhanced analysis capabilities necessary to monitor international and domestic financial markets, coordinate actions with other Federal agencies, foreign governments, and global financial markets, and manage the Treasury's global operations on a round the clock basis. It will have a capability to integrate open source and classified information that currently does not exist in the Treasury organizational structure. The speed with which financial information is processed and the fact that decisions facing the United States are not limited to weekdays from 9–5, dictate the creation of a 24/7 facility that will protect and enhance the fiscal power and reach of the United States Government.

Additionally, the Treasury Operations Center will act as a communications hub for information directly related to the financial markets as well as to national and world events that affect the markets. This communications hub will tie together the

Treasury program offices with their private sector counterparts, foreign financial ministries, and other federal government entities. The Treasury Operations Center will engage directly with international financial market participants, foreign governments, international financial institutions, and in multinational fora in an immediate time-sensitive manner. Open and secure communications capabilities will be available, as will a 24/7 executive switchboard.

Lastly, the Treasury Operations Center will function as a crisis management center. It will be the hub for activities bringing senior Treasury Department officials together to manage rapidly developing issues affecting the financial community (for example, managing the recent sub-prime mortgage situation and bolstering confidence in the investment banking community). Current financial crises require the Secretary to manage operations on a daily if not hourly basis, as well as implementing policies that affect the future course of the nation's economic health. Open and secure conference rooms will be available, along with fully equipped private office space.

CROSS-BORDER WIRE TRANSFERS

Question. In October of 2006, Treasury's Financial Crimes Enforcement Network released a study that found that it is technically feasible to require financial institutions to report data on wire transfers that cross borders. What is the status of Treasury's efforts to implement reporting of Cross-Border Wire Transfers?

Answer. The Financial Crimes Enforcement Network (FinCEN) continues to study regulatory proposals for the collection of Cross-Border Electronic Transmittals of Funds. FinCEN is currently analyzing the costs and benefits of a proposed regulation that will affect law enforcement and regulatory agencies, and the financial industry. Upon completion of the study, a report will be provided to the Secretary for review and consideration.

Question. Have you conducted any analyses in order to weigh the additional costs that data reporting on cross border wire transfers might impose on the financial sector against the benefits of gathering this data?

Answer. As mentioned above, FinCEN is actively engaged in a review of the costs and benefits of a proposed regulation to collect Cross-Border Electronic Transmittals of Funds. Data collection efforts that contribute to the evaluation of costs and benefits include surveys, in-person interviews, and "use case scenarios." Specifically, FinCEN has reached out to affected parties of the Bank Secrecy Act Advisory Group (BSAAG), a statutorily created forum for discussing Bank Secrecy Act (BSA) administration, to assess the impact on industry. FinCEN has also coordinated with the Federal Reserve Board to survey financial institutions that transmit funds internationally. This voluntary survey asked institutions to identify the impact of a reporting requirement, including the cost of reporting such information. Finally, FinCEN conducted in-person interviews with law enforcement and regulatory agency officials and collected "use case scenarios," which are specific examples of exactly how the agencies would use the cross border data and its resulting benefits.

BUDGETARY IMPLICATIONS OF CUBA SANCTIONS

Question. How many fiscal year 2008 budget and staff resources (stated in dollars and actual staff, either part-time or full-time, and work location) are presently designated for administering the Cuba sanctions? What proportion of total Treasury/OFAC resources do those levels represent?

Answer. Most of OFAC's Cuba-related work is centered in its Licensing Division and includes processing applications for travel to Cuba to market and sell agricultural products to Cuba as provided for by the Trade Sanctions Reform and Export Enhancement Act of 2000, as well as applications to engage in family and religious travel and other Cuba-related transactions. Of the 155 OFAC FTE, six FTE (approximately $1.1 million) in Washington, DC and five FTE (approximately $.9 million) in Miami, FL are devoted full-time to the Cuba program. These eleven FTE represent approximately seven percent of OFAC's budget. In addition, some other individuals, including supervisors, who dedicate time to one or more of the other 20-plus sanctions programs administered by OFAC, work on aspects of the Cuba program as necessary.

Question. How do those levels compare to the resources that are devoted to the other sanctions programs that OFAC implements, including sanctions related to terrorism, weapons proliferation, and narcotics trafficking?

Answer. The balance of OFAC's budget (approximately ninety-two percent) is devoted to the other 20-plus sanctions programs that OFAC implements, including those related to Iran, Sudan, terrorism, weapons proliferation, and narcotics trafficking. However, as noted in the response to the question above, some individuals, including supervisors, who dedicate time to one or more of the other sanctions programs administered by OFAC, work on certain aspects of the Cuba program as necessary.

Within OFAC's Designations Investigations Division, there are currently six FTE (two of which are currently vacant) devoted full-time to administering counter-terrorism sanctions programs; eight FTE devoted full-time to administering counter-proliferation sanctions programs; eleven FTE devoted full-time to administering counter-narcotics sanctions programs; and eight FTE (two of which are currently vacant) devoted full-time to administering country/regime sanctions programs. These figures are fluid and the resources assigned to administer these programs can change at any time to accommodate foreign policy interests and national security priorities. The FTE within the other operating divisions (Licensing, Policy, Compliance, Civil Penalties and Enforcement) are not assigned to administer and implement specific sanctions programs; rather, these divisions assign employees on a cross-program basis.

It should be further noted that in 2005, as part of the creation of the Office of Terrorism and Financial Intelligence, twenty-three analysts assigned to OFAC's terrorism sanctions program in the Foreign Terrorist Division of OFAC were transferred to Treasury's Office of Intelligence and Analysis (OIA) to form the nucleus of OIA's analytic team. These analysts have continued to support OFAC's counter-terrorism sanctions program through in-depth targeting, research, analysis, and drafting of evidentiaries. Over time, the number of analysts assigned to counter-terrorism work in OIA has grown to thirty-five, strengthening and deepening Treasury's counter-terrorism sanctions program and also allowing OIA to provide expanded analytical support to the Treasury Department and interagency community on terrorist financing matters.

Question. How do the fiscal year 2008 levels (resources and staffing) compare to funds and personnel devoted to Cuba efforts in the previous four fiscal years (fiscal years 2004 through 2007)?

Answer. In fiscal year 2008, OFAC employed new strategies on Cuba matters in the Enforcement and Civil Penalty divisions that have reduced and are expected to continue to reduce resources committed to Cuba; specifically, OFAC increased its targeting of enforcement efforts by concentrating on those facilitating illegal travel to Cuba. It is expected that the percentage of staff time expended by the Enforcement and Civil Penalties divisions on Cuba matters will decrease as a result of the new strategies being deployed. Resources and staffing devoted to Cuba will otherwise remain consistent with the previous four fiscal years (fiscal years 2004 through 2007).

Question. Please provide the Subcommittee with a data table detailing the resources (dollars and personnel) allocated for fiscal year 2008 for investigating and penalizing violations of the Cuba embargo, describing the types of activities involved, and specifying, for comparison purposes, the amounts dedicated to each of the other 20-plus sanctions programs that OFAC administers.

Answer. As noted above, OFAC has adopted new strategies with respect to sanctions violations in recent years. These strategies have resulted in a significant reduction in Cuba penalty cases. Enforcement resources committed to Cuba are also being reduced and enforcement efforts are being targeted in a more effective way by concentrating on those facilitating illegal travel to Cuba. The data table below identifies the FTE within OFAC that are devoted to administering and implementing the Cuba program for fiscal year 2008.

As previously noted, some individuals, including supervisors, who dedicate time to one or more of the other 20-plus sanctions programs administered by OFAC, work on aspects of the Cuba program as necessary. Because of the significance and demands related to the other programs to which these individuals are assigned, OFAC does not track their time spent on the Cuba program. For comparison purposes approximately ninety-two percent of OFAC's budget is devoted to other sanctions programs that OFAC implements, including sanctions related to Iran, Sudan, terrorism, weapons proliferation, and narcotics trafficking.

FISCAL EYAR 2008

[Dollars in thousands]

Divisions with FTE dedicated to a specific program [1]	Cuba		All other programs		Total	
	FTE	Dollars	FTE	Dollars	FTE	Dollars
Licensing	11	$1,969	....	....	11	$1,969

FISCAL EYAR 2008—Continued

[Dollars in thousands]

Divisions with FTE dedicated to a specific program [1]	Cuba		All other programs		Total	
	FTE	Dollars	FTE	Dollars	FTE	Dollars
Designations Investigations:						
Counterterrorism	....	....	6	$1,041	6	1,041
Counterproliferation	....	....	8	1,388	8	1,388
Counternarcotics	....	....	11	1,909	11	1,909
Country/regime	....	....	8	1,388	8	1,388
Total	11	1,969	33	5,726	44	7,695

[1] As noted above, OFAC's other operating programs assign FTE on a cross-program basis rather than to a particular sanctions program.

MANAGEMENT OF TREASURY'S IT SYSTEMS

Question. The Inspector General's 2008 Annual Plan repeats a continuing concern with the Department's management of large capital investments—particularly information technology (IT) investments. While this is a challenge for any organization, the Department has had particular problems in this area. How are you addressing these deficiencies from a department-wide perspective? What measures and procedures are in place to ensure the success of new systems?

Answer. Over the past year, the Department has taken a number of significant steps to address the IT management challenges. The Department's strategy has focused on three key elements: (1) regular engagement of the Treasury Department and Bureau executives in the management of IT; (2) more rigorous planning and management of IT projects; and (3) improved IT investment review and evaluation tools, processes and practices.

In order to better engage executives across Treasury and its Bureaus, the Department has revitalized the Executive Investment Review Board (E-Board), which was a key recommendation by the Government Accountability Office's July 2007 report (GAO–07–865). The E-Board was re-chartered in December 2007 and held its first meeting in February 2008. The E-Board is chaired by the Deputy Secretary and is comprised of the heads of each of the Department's Bureaus. The Assistant Secretaries for Management and Legislative Affairs, the General Counsel and the Chief Information Officer (CIO) also participate on the E-Board. The E-Board is tasked with ensuring the Department's IT portfolio decisions are driven by Treasury's business requirements and that each Bureau and the Department have in place appropriate planning, monitoring and evaluation mechanisms. The E-Board will also identify strategic priorities for IT use and address Department-wide IT policy issues as they arise.

To improve the effectiveness of planning and management of IT projects, the Treasury CIO has issued new policy and guidance regarding requirements for project planning in order to receive CIO endorsement for funding. The CIO, in collaboration with the Treasury Chief Procurement Executive, has drafted a new IT acquisition policy to strengthen the Department's IT contract management. The Department is working with the bureaus to implement the new OMB required, Federal Acquisition Council Project and Program Management qualifications to ensure that the Treasury federal staff that oversee our IT projects have the appropriate knowledge and skills required to successfully deploy and manage Treasury IT systems. Finally, the Department continues to strengthen its ability to defend against cyber attacks and protect the sensitive information entrusted to the Treasury by the public.

Another element of the Department's overall IT management strategy is to improve the review and evaluation of Treasury IT investments. Rigorous review at both the bureau and Department level is a prerequisite for successful deployment and management of IT systems. In addition, the Treasury CIO has taken action to improve the Department's visibility into and influence on IT projects. In the fall of 2007, the Treasury CIO made the decision to require non-major investments to participate in a process similar to the Department's formal selection and review processes for major investments. As a result, all IT investments (both major and non-major) are considered during the portfolio selection process that is integrated with the Department's budget request. Likewise, bureaus must report quarterly for all IT investments (both major and non-major) on cost, schedule, and performance goals. Finally, the Treasury CIO is expanding its IT investment evaluation process to assess not only "completed" projects against planned objectives, but also those portions of IT developmental projects that have implemented discrete operational components.

Question. The President's fiscal year 2009 budget requests $2.9 million to fund an upgrade to the IT system used for financial reporting under the Bank Secrecy Act. In July 2006, FinCEN halted work on BSADirect, the previous attempt to upgrade its IT systems. Treasury spent two years of planning and $14.4 million on that failed system. What improvements have you made to the planning and implementation process that will avoid problems that plagued the previous failed upgrade?

Answer. During fiscal year 2007, FinCEN made significant progress on the full range of organizational, program management, and technical architecture-related efforts needed to modernize the bureau's IT systems. FinCEN identified the specific action items in its October 2006 Information Technology Plan, created in response to the BSA Direct project termination. In fiscal year 2007, FinCEN launched an effort to establish the organization's first enterprise business transformation and IT modernization strategy, which serves as the roadmap for aligning FinCEN's IT portfolio with business objectives and processes. FinCEN also expanded its capacity for executing complex IT projects by (1) hiring new project managers; (2) introducing management tools and techniques through the creation of a Project Management Office; (3) establishing a Data Management Framework to improve the management and visibility of BSA data issues; (4) awarding a performance-based contract for acquiring IT services; (5) and strengthening collaboration with internal and external stakeholders. FinCEN is also fully engaged in Treasury's revised processes in the question above.

Question. The President's fiscal year 2009 budget requests $3 million for a new debt management system. Treasury reports that the new system will enhance the efficiency of federal borrowing, which will save taxpayers money. How much do you estimate that the current system is costing taxpayers? What kind of return will the taxpayers get on this investment?

Answer. Currently, Treasury's Office of Debt Management (ODM) spends approximately $600,000 annually to manage its $9+ trillion liability portfolio. Given the size of the portfolio, ODM believes there is significant opportunity cost foregone due to its current outdated IT infrastructure and modeling capabilities which limit sophisticated portfolio analysis.

Treasury issues $4.3 trillion of debt per year using basic Excel spreadsheets and manual operations. The current size of Treasury's marketable debt portfolio is $4 trillion, with an annual interest cost of $244 billion in 2007. The additional funds to improve ODM's systems will make a huge difference in costs. For example, if the Department can issue just $1 billion less over a one month period due to better portfolio analytics and sound modeling capabilities, Treasury would save $3 million at current interest rates. Over the long term, the Department could potentially save one one-hundredth of a percent (.0001) on the $4 trillion marketable debt portfolio, resulting in potential interest costs savings of over $400 million annually. We believe this cost saving is conservative, and that additional savings are eminently possible given better risk management systems and operations.

More importantly, for global financial markets, a disruption in the ability to make debt issuance decisions or the inability to function in the event of a contingency event would precipitate severe financial distress and cost. Since every fixed income market in the world is tied to the Treasury market, such disruption would be significantly costly from a financial perspective.

The proposed systems would provide: (1) a robust infrastructure on top of the new Treasury auction system (providing 24/7 reliability, back office servicing, and applications development), (2) a secure contingency site with numerous business continuity options, (3) the ability to remotely access and make debt issuance recommendations, (4) the ability to make informed debt issuance decisions using advanced portfolio analytics, (5) the ability to provide key interest rate data to Congress as mandated and to financial markets as necessary without interruption, and (6) major infrastructure upgrades (including servers which are severely antiquated). The immediate implementation of these systems is necessary for the national and financial security of the United States.

COMMITTEE ON FOREIGN INVESTMENT IN THE UNITED STATES (CFIUS)—CASELOAD MANAGEMENT

Question. The Foreign Investment and National Security Act of 2007 became law in July of 2007, increasing Congressional oversight of the CFIUS review process. How is the Department preparing to meet the increase in requirements under the new law?

Answer. CFIUS and Treasury have been in compliance with the requirements of the Foreign Investment and National Security Act (FINSA) since FINSA became effective in October 2007. To ensure that Treasury and all CFIUS agencies comply fully with FINSA and meet the increased Congressional oversight requirements that it presents, the Department has made multiple changes and taken multiple steps, which include: increases in staffing levels, increases in accountability, and higher level cooperation between CFIUS agencies and agencies outside of the CFIUS process.

Regarding staffing, Treasury and other CFIUS agencies have substantially increased staffing for CFIUS-related issues. In Treasury, we established a new Deputy Assistant Secretary position focused on CFIUS issues and reporting to the Assistant Secretary and the Under Secretary for International Affairs. Treasury has also hired additional staff to handle the increased requirements, including reporting requirements under FINSA and the increased case load. The total number of full-time staff assigned to work on investment security issues in Treasury has nearly tripled, rising from 5 full-time positions to 14.

On accountability, CFIUS has implemented formal processes to ensure that CFIUS matters are fully considered at the highest levels. This includes strong internal procedures to ensure that every case is certified at the Assistant Secretary or Deputy Secretary level, as appropriate, that the required post-review or post-investigation certifications are submitted to Congress in a timely manner, and that requested briefings are provided to Congress as required.

On coordination, Treasury (in consultation with other CFIUS agencies) has issued internal CFIUS guidelines to ensure that the reporting requirements under FINSA are fully satisfied in a timely manner. CFIUS agencies meet each week to discuss and deliberate on all cases before CFIUS, and where appropriate, outside agencies and departments (such as the Departments of Transportation and Health and Human Services, and NASA) are called on to bring their expertise into the CFIUS process. Improvements have also been made in intelligence analysis, which is now being coordinated by the Director of National Intelligence, who is consulting with each of the key intelligence agencies in the U.S. government. Further, the Executive Order issued by the President on January 23, 2008, establishes executive branch rules to ensure that CFIUS is able to meet the reporting requirements under FINSA in an efficient and orderly manner. Treasury is coordinating with other CFIUS agencies to submit the required annual report to Congress by July 31, 2008.

Question. I understand that the CFIUS caseload has increased over the last few years. Why are we seeing such a dramatic increase, and how is Treasury adapting to respond to this increase while ensuring that the CFIUS cases are completed in a reasonable time frame?

Answer. There are numerous reasons for the recent increase in the CFIUS caseload, including the rate of foreign direct investment into the United States, heightened public awareness of the CFIUS review process following several high-profile cases in recent years, and increased recognition among businesses that certain transactions could raise national security considerations in the current security environment. In addition, there have been a number of "defensive" filings where there is a cross-border acquisition that has little relevance to national security.

In the last few years, Treasury has made numerous organizational and procedural improvements to ensure that all cases continue to be processed efficiently, with all national security considerations fully analyzed. As noted above, Treasury established a new Deputy Assistant Secretary position in 2006 focused on CFIUS issues. Treasury has also hired additional staff to focus on CFIUS issues. Meanwhile, the increased caseload requires additional resources to be dedicated to CFIUS matters. The regulations and guidance that Treasury will be publishing this spring will also help ensure an efficient process.

Further, CFIUS agencies have made it clear to companies and their advisors that, where appropriate, advance pre-filing briefings and consultations ensure that CFIUS has adequate time for reviews.

INTEGRATION OF TREASURY INTO U.S. INTELLIGENCE COMMUNITY

Question. How well is the Office of Terrorism and Financial Intelligence being integrated in the intelligence community?

Answer. Since its creation in 2004, the Office of Intelligence and Analysis (OIA)—Treasury's Intelligence Community (IC) component—has become a fully-integrated member of the IC. OIA is recognized as a key player in IC efforts to address the financial underpinnings of national security threats and threats to international financial stability. The Assistant Secretary for Intelligence and Analysis is a member of the Director of National Intelligence's (DNI) Executive Committee (the IC's

"Board of Directors") and OIA is an active participant in the various working groups and committees guiding IC efforts against key threats, including the National Intelligence Analysis Production Board, the Counterterrorism Advisory Group, the IC Leadership Council, the WMD–T Steering Group, and the Interagency Intelligence Committee on Terrorism. The Office of the Director of National Intelligence recently acknowledged OIA's status as a key IC figure by asking it to serve as the National Intelligence Priorities Framework Topic Expert for Economic Stability and Financial Networks.

OIA routinely coordinates on (and provides input to) articles drafted for the National Terrorism Bulletin (NTB) and the President's Daily Brief. In addition, OIA provides regular support to the Federal Bureau of Investigations (FBI) counterterrorism investigations, and frequently offers input to counterterrorism and counterproliferation analytic products drafted by the FBI, the Central Intelligence Agency (CIA), and other IC agencies. On numerous occasions, OIA analysts have drafted intelligence reports jointly with their counterparts at the FBI and CIA. In order to strengthen cooperation with these agencies, OIA has detailed officers to the FBI's Terrorist Finance Operations Section and to the CIA. OIA also has officers forward-deployed to U.S. Central Command, U.S. Pacific Command, U.S. European Command, and the joint Treasury-DOD Iraq Threat Finance Cell in Baghdad. OIA is in the process of identifying an officer to serve as Treasury's representative to the DNI's National Intelligence Coordination Center (NIC–C). The Defense Intelligence Agency, and the National Security Agency have assigned officers to OIA to facilitate cooperation and information sharing.

Question. What improvements are needed to maximize the ability of Treasury and other components of the intelligence community to exchange critical information?

Answer. OIA's fiscal year 2009 Global Finance Initiative (GFI) would give Treasury the resources it needs to successfully leverage its status as a fully-integrated member of the IC. GFI would provide $2 million, including a realignment of $1 million in Department base resources, and 10 positions to establish a capability in OIA to advance global finance intelligence issues within the IC. Resources would be targeted to: (a) aligning IC collection requirements on finance-related issues more closely with policymaker needs, (b) developing and taking advantage of new sources of information, (c) enhancing analysis on finance-related issues in coordination with the IC, and (d) expanding OIA's role and relationships within the IC. This initiative is aligned with key tasks and objectives of the National Security Strategy, the National Intelligence Strategy, the National Implementation Plan for the War on Terror, and the Treasury Strategic Plan.

GFI would enhance the effectiveness of IC collection and analysis on global financial networks. Addressing global financial networks involves assessing the financial underpinnings of national security threats, identifying our adversaries' financial vulnerabilities, measuring the impact of targeted financial measures, and uncovering threats to the stability of the international financial system. By assuming a greater role in guiding financial intelligence collection and analysis, OIA would address a growing need in the IC, and take a large step toward meeting the expectations of Congress and Treasury leadership when they created OIA.

Question. What organizational, technical, or other types of barriers hamper the ability of the office to fit successfully into the overall intelligence community, and how are those impediments being addressed?

Answer. Since its creation in 2004, the Office of Intelligence and Analysis (OIA)—Treasury's Intelligence Community (IC) component—has made great strides in its efforts to integrate itself into the IC. OIA is recognized as a key player in IC efforts to address the financial underpinnings of national security threats and threats to international financial stability. OIA's fiscal year 2009 Global Finance Initiative (GFI) would give Treasury additional resources for aligning collection requirements on finance-related issues more closely with policymaker needs; developing and taking advantage of new sources of information; enhancing analysis on finance-related issues in coordination with the IC; and expanding OIA's role and relationships within the IC.

Despite these advancements, OIA faces significant challenges in hiring highly qualified analysts. The conventional hiring process is cumbersome and lengthy, and competition within the Intelligence Community for qualified candidates is fierce. The Treasury Department strongly supports section 121 of the fiscal year 2009 Intelligence Authorization Bill, which establishes the authority to convert positions within the intelligence component of the Treasury Department, DHS, and other departmental intelligence components to excepted service status, which would go a long way towards leveling the playing field.

QUESTIONS SUBMITTED BY SENATOR SAM BROWNBACK

Question. Could you give us an update on how your "HOPE NOW alliance" is working to prevent further foreclosures in the nation's housing market?

Answer. Treasury is pleased with progress of the HOPE NOW Alliance, a private group of lenders, servicers, non-profit counselors and trade organizations that was initially facilitated by Treasury and HUD. However, we recognize more work remains. As of February 29, 2008, the industry had helped almost 1.2 million homeowners find alternatives to foreclosure through either a loan modification or repayment plan since July of 2007. These data do not include refinancing statistics. Of particular significance is the fact that modifications are continuing to rise as a proportion of work-outs. In February alone, 39,000 subprime borrowers received loan modifications. Modifications accounted for more than 38 percent of borrower workout plans in February, up from just under 19 percent in July 2007. In total, the three-month rate of change in modifications was up approximately 40 percent in February, while the rate of change in foreclosure starts was up only 16 percent.

FHA has also aided HOPE NOW's efforts and played a vital role in helping more current and delinquent homeowners find affordable solutions. The recent announcement to expand FHA Secure to more delinquent borrowers will enable FHA to refinance an additional 100,000 homeowners this year. In total, FHA Secure is estimated to refinance up to 500,000 homeowners by the end of 2008.

Through a variety of outreach tools and operational best practices established by HOPE NOW, Treasury believes the Alliance has laid the groundwork for increased success in the coming months.

It is imperative that HOPE NOW continue to improve on its progress to date, and Treasury will be sure to consistently convey that message to the Alliance.

Question. What are your thoughts on the Durbin Bankruptcy bill that would allow judges to re-write loan provisions? What would be the effects on the banking system of the provisions of this bill?

Answer. While Treasury respects the efforts of Senator Durbin to explore potential solutions for the current mortgage market downturn, Treasury is concerned about the unintended consequences such legislation may have on the mortgage market in going forward.

Amending the bankruptcy code in this manner would undermine existing contracts, leading to a contraction in available and affordable mortgage credit. This bankruptcy provision would rewrite certain tenets of bankruptcy law in ways that would fundamentally alter the expectations of parties to thousands of home purchases after the fact. These provisions would also likely prolong the time it will take the market to recover from the current downturn.

Question. I understand that the World Bank is sending U.S. taxpayer funds to Iran through banks that we have already sanctioned as WMD proliferators. What is the Treasury Department doing to try to stop this from happening, since it is contrary to everything we are trying to accomplish with our Iran policy?

Answer. The Administration shares Congressional concern with the deceptive practices of Iranian financial institutions and the involvement of these institutions in proliferation activities. The Treasury Department has been a leader in singling out Iranian banks for sanctions as a result of their illicit activities.

The Department has worked closely and diligently with the World Bank to ensure that it is fully abreast of the evolving sanctions being put in place by the United Nations Security Council, the inter-governmental Financial Action Task Force (FATF), and the most recent Treasury Department designation of Future Bank as being controlled by Iran's Bank Melli.

The Administration has taken and will continue to take an active role in opposing World Bank lending to Iran. The United States has opposed every proposal for Iran since the early 1980s. However, despite these efforts, projects have been approved by the 24-member Board and continue to disburse funds. The Department has been assured that disbursement of loan proceeds under these World Bank-financed projects and the project accounts have been transferred to commercial banks which are neither on the list of entities sanctioned pursuant to the U.N. Security Council resolutions nor on the list of entities sanctioned for nuclear proliferation activities by the U.S. Treasury. When making such disbursements, the World Bank screens the list of beneficiary entities as well as financial intermediaries against the U.N. list maintained pursuant to the aforementioned U.N. Security Council decisions, and the list maintained by the Treasury Department's Office of Foreign Assets Control (OFAC).

The Treasury Department will continue to strongly oppose and vote against any World Bank Group loan or other type of assistance to Iran and will also ensure that the Bank continues to comply with the full range of sanctions regimes to avoid any activity that could facilitate Iran's nuclear or missiles programs.

Question. We have enacted legislation to allow States to divest from Sudan. What are your thoughts on allowing States to divest from Iran?

Answer. The Administration shares Congressional concern with the conduct of the Iranian regime, and the Treasury Department has played a leading role in seeking to isolate Iran financially. Such efforts targeting Iran are most likely to succeed if they are multilateral in nature, and much of our effort has been targeted at persuading our allies and private sector institutions to cut back or terminate their financial dealings with Iran. The multilateral efforts that resulted in the recent United Nations Security Council Resolution with respect to Iran (U.N. Security Council Resolution 1803, passed March 3, 2008) are but one example of the cooperation we are receiving from our allies abroad. Legislation authorizing divestment from companies that do business in Iran risks alienating the very allies whose assistance we need. It also limits the President's ability to conduct U.S. foreign policy with one voice.

Question. You've asked for some increases in your budget for the Office of Terrorism and Financial Intelligence. Can you update us on the progress you have made in cutting off funds to terrorist organizations and rogue nations?

Answer. The Office of Terrorism and Financial Intelligence (TFI) has made significant progress in this area by using a combination of financial measures, fueled by financial intelligence, in a way that engenders the support of other governments and the private sector. TFI has successfully drawn on a range of tools for this effort, including executive orders issued by the President pursuant to the International Emergency Economic Powers Act, Section 311 of the USA PATRIOT Act, and FinCEN advisories. Combining these authorities with targeted intelligence about illicit financing networks, TFI has used conduct-based, intelligence-grounded, targeted financial measures to address the threat of terrorist organizations and rogue nations in a way that encourages support from both the private sector and larger international community.

Executive Order (E.O.)13224 has proven to be a powerful and flexible tool for targeting terrorist organizations, allowing the Department to block the assets of individuals and entities controlled by or acting on behalf of named terrorist organizations, freezing any of the target's assets that are held by U.S. persons and preventing U.S. persons from having any future dealings with them. To date, the United States has designated 486 individuals and entities pursuant to E.O. 13224, of which nearly 400 were named by Treasury. In addition, 19 individuals and entities have been designated pursuant to E.O. 12947, which prohibits transactions with terrorists who threaten the Middle East peace process.

Treasury has also drawn on this range of tools to influence the conduct of rogue nations like North Korea, using targeted financial measures and systemic controls like those previously described. In the case of North Korea, the Department took two important actions to address conduct ranging from WMD proliferation-related activities to counterfeiting of U.S. currency and other illicit behavior. First, a number of North Korean proliferation firms were targeted under E.O. 13382. That Order authorizes the Treasury and State Departments to target key nodes of WMD and missile proliferation networks, including their suppliers and financiers, in the same way as is done with terrorists. A designation under this order cuts the target off from access to the U.S. financial and commercial systems and puts the international community on notice about a particular threat. Second, regulatory action was taken to protect the financial system against Banco Delta Asia (BDA). In September 2005, Treasury designated BDA as a primary money laundering concern. At that time, Treasury issued a proposed rule, which was subsequently finalized in March 2007, prohibiting U.S. financial institutions from opening or maintaining correspondent accounts for or on behalf of BDA. Treasury took this step to protect the U.S. financial system from BDA, which exhibited systemic failures in its application of appropriate standards and due diligence, as well as its facilitation of unusual or deceptive financial practices by North Korean-related clients. In addition to protecting the U.S. financial system from the significant vulnerability that BDA represents, the Section 311 action has spurred improvements in Macau's regulatory environment. Following the BDA action, the Macanese authorities took substantial steps to strengthen Macau's anti-money laundering and counter-terrorist financing regime, notably by passing a new law to strengthen these controls and starting the jurisdiction's first-ever Financial Intelligence Unit (FIU). Perhaps most importantly, the action against BDA has had a profound effect, not only in protecting the U.S. financial system from abuse, but also in notifying financial institutions and jurisdictions globally of an illicit finance risk. Following these actions, responsible foreign jurisdictions and institutions have taken steps to ensure that North Korean entities engaged in illicit conduct are not receiving financial services.

Question. You have identified the targeting of state sponsors of terrorism such as Iran and Syria as an immediate challenge for the Office of Terrorism and Financial Intelligence (TFI). What can you tell us about those activities and the progress you have made so far?

Answer. TFI has taken important steps with both Iran and Syria by using a combination of financial measures, fueled by financial intelligence, to target their conduct in a way that engenders the support of other governments and the private sector.

Syria.—Targeted financial measures have proved effective in addressing the threat Syria's problematic behavior poses to the United States. To respond and take additional measures to address this threat to our national security, foreign policy, and economy, President George W. Bush issued E.O. 13460 on February 13, 2008. This measure targets individuals and entities determined to be responsible for or who have benefited from the public corruption of senior officials of the Syrian regime. On February 21, 2008, the Treasury used this authority to designate Rami Makhluf, a powerful Syrian businessman and regime insider whom improperly benefits from and aides the public corruption of Syrian regime officials. In addition to this use of targeted economic sanctions against Syrian entities involved in WMD proliferation, Treasury has taken action under Section 311 to protect the U.S. financial system against the Commercial Bank of Syria (CBS), which has been used by criminals and terrorists to facilitate or promote money laundering and terrorist financing, including the laundering of proceeds from the illicit sale of Iraqi oil and the channeling of funds to terrorists and terrorist financiers. In March 2006, Treasury issued a final rule, pursuant to Section 311, designating CBS as a "primary money laundering concern" and requiring U.S. financial institutions to close correspondent relationships with CBS. Consequently, prominent international financial institutions have begun to reassess their relationships with Syria and a number of Syrian entities.

Iran.—Due to U.S. concern about Iran's well-documented illicit behavior, the Treasury Department maintains broad sanctions against Iran (measures that build upon our overall and long-standing Iran policy). U.S. commercial and financial sanctions against Iran, as administered by OFAC, prohibit U.S. persons from engaging in a wide variety of trade and financial transactions with Iran or the Government of Iran, and prohibit most trade in goods and services between the United States and Iran, and any investments by U.S. persons in Iran. U.S. persons are also prohibited from facilitating transactions via third-country persons that they could not engage in themselves. Against this backdrop of long-standing sanctions against Iran, Treasury has taken a number of actions to address the threat of Iranian proliferation activity in recent years.

First, while under our general Iran country sanctions program, Iranian financial institutions are prohibited from directly accessing the U.S. financial system, they are permitted to do so indirectly through a third-country bank for payment to another third-country bank in transactions not involving the United States or U.S. persons. In September 2006, OFAC cut off one of the largest Iranian state-owned banks, Bank Saderat, from any access, including this indirect, or "u-turn," access to the U.S. financial system. This bank, which has approximately 3,400 branch offices, is used by the Government of Iran to transfer money to terrorist organizations. As noted below, OFAC later designated Bank Saderat for its support for terrorist groups.

Second, OFAC is relying increasingly on the targeted financial measures to combat Iran's pursuit of nuclear capability, development of ballistic missiles, and its support for terrorism. With respect to Iran, OFAC has been able to apply these measures in the context of U.N. Security Council Resolution (UNSCR) 1737 and 1747, enabling the Department to secure greater multilateral implementation by governments and the private sector and use targeted financial measures against Iranian individuals and entities in both our counterterrorism and counterproliferation sanctions programs. Treasury took several major actions under these programs in October 2007, building on previous successes with designations of Iranian entities supporting proliferation using U.S. unilateral authorities and at the United Nations. On October 25, 2007, Treasury and State (acting in tandem) were able to expose Iranian banks, companies, and individuals that had been involved in proliferation and terrorism-related activities and cut them off from the U.S. financial system. These actions included making:

—Treasury designations of two of Iran's state-owned banks (Banks Melli and Mellat) and three individuals affiliated with Iran's Aerospace Industries Organization (AIO) for proliferation activities under E.O. 13382;

—Treasury designations of nine Islamic Revolutionary Guard Corps (IRGC)-affiliated entities and five IRGC-affiliated individuals as derivatives of the IRGC under E.O. 13382;
—The designation of the IRGC-Qods Force (IRGC–QF) under E.O. 13224 for providing material support to the Taliban and other terrorist organizations; and
—The designation of Iran's state-owned Bank Saderat as a terrorist financier.

Many of the U.S. designations against Iranian entities and individuals under E.O. 13382 have been similarly designated under UNSCR 1737 and UNSCR 1747. Most recently, UNSCR 1803 added additional names to the growing list of Iranian individuals and entities that are subject to multilateral targeted financial sanctions. UNSCR 1803 also includes a warning regarding Iranian financial institutions more generally, establishing obligations for U.N. member states to exercise vigilance over their own financial institutions activities with financial institutions domiciled in Iran, and their branches and subsidiaries abroad. The Resolution further names two Iranian financial institutions that Treasury previously designated, Bank Melli and Bank Saderat, as institutions of particular concern.

Third, in addition to these "formal" actions, the Treasury has engaged in unprecedented, high-level outreach to the international private sector, meeting with more than forty banks worldwide to discuss the threat Iran poses to the international financial system and to their institutions. Through this outreach, OFAC has shared information about Iran's deceptive financial behavior and raised awareness about the high financial and reputational risk associated with doing business with Iran. The use of targeted measures has aided this effort by highlighting specific threats, helping isolate these bad actors, and preventing them from abusing the financial system. By thus partnering with the private sector, there is an increasingly less desire to work around sanctions. Even those institutions not formally bound to follow U.S. law pay close attention to the targeted actions and often adjust their business activities accordingly. Many leading financial institutions have scaled back dramatically, refused to issue new letters of credit to Iranian businesses, or even terminated their Iran-related business entirely. They have done so of their own accord, many concluding that they did not wish to be the banker for a regime that deliberately conceals the nature of its dangerous and illicit business.

TFI has also communicated with the U.S. financial sector regarding Iran through the issuance of advisories. In October 2007, following a statement by the FATF on the threat posed by deficiencies in Iran's anti-money laundering/combating the financing of terrorism regime, the FinCEN followed suit by issuing an advisory to alert U.S. financial institutions of similar concerns regarding Iran. In this advisory, FinCEN advised that financial institutions should be particularly aware that there may be an increased effort by Iranian entities to circumvent sanctions and related financial community scrutiny through the use of deceptive practices involving shell companies and other intermediaries or requests that identifying information be removed from transactions. The advisory went on to explain that such efforts may originate in Iran or Iranian free trade zones subject to separate regulatory and supervisory controls, including Kish Island. Such efforts may also originate wholly outside of Iran at the request of Iranian-controlled entities.

Question. Treasury's Office of Intelligence Analysis was established in fiscal year 2005. Since that time, how has it contributed to overall intelligence collection?

Answer. OIA has limited authority to collect foreign financial and monetary information, and general foreign economic information. OIA's primary mission is to analyze intelligence collected by other agencies in order to support the formulation of Treasury policy and the execution of its authorities. To support its mission, OIA leadership firmly believes that the organization should drive intelligence collection by providing timely and insightful analytic support to IC members engaged in clandestine and open-source intelligence activities. OIA analysts routinely provide their intelligence requirements to collectors at the Central Intelligence Agency, the National Security Agency, the Federal Bureau of Investigation, the Defense Intelligence Agency, and other IC elements in order to help those organizations more effectively direct their resources. OIA also provides feedback to IC Collectors as to the timeliness, relevance, and accuracy of the information provided by their sources. All in all, this support helps ensure that scarce IC collection resources are focused on the hardest targets and finance-related collection requirements are closely aligned with policymaker needs.

In fiscal year 2008, OIA is expanding its ability to drive collection by increasing its cadre of dedicated Requirements Officers. OIA's fiscal year 2009 Global Finance Initiative (GFI) would provide additional resources to ensure that each of OIA's core mission areas receives dedicated collection requirements support.

Question. Question from the Republican Staff Director of the JEC:

Recent turmoil in financial markets is continuing, particularly the markets for asset backed debt instruments. It's clear that in many instances debt that received a AAA-rating was in fact not AAA grade at all. Up until now, the credit rating agencies have relied solely on traditional risk indicators, all of which are either borrower-focused or collateral-focused.

It seems that both home owners and mortgage lenders alike could benefit from an independent, objective and standardized third-party verification step that verifies the quality and risk associated with these loans before they are sold on the secondary market or before they are finalized by a broker. Consumers and investors could also benefit by having the ability to review the record of particular lenders.

Do you believe that assigning such a pre-securitization rating based upon borrower information, adequacy of collateral and loan quality would help to prevent future crises in the mortgage market?

Answer. On March 13th, the President's Working Group on Financial Markets (PWG), which is chaired by the Secretary, released the comprehensive "Policy Statement on Market Developments." The PWG's statement was intended to help to restore market liquidity, market discipline, and investor confidence through recommendations to enhance disclosure/transparency, due diligence/independent analysis, valuation techniques, risk management practices, regulatory policies, and market infrastructure. There are recommendations for all stakeholders (all market participants and regulators) and for all links in the chain of the securitization process (mortgage brokers, originators, securitizers, financial institutions, credit rating agencies, investors, and state and federal regulators).

The PWG made several recommendations to improve the quality and disclosure of information about and analysis of mortgage loans underlying securitized products, including:

—All states should implement strong nationwide licensing standards for mortgage brokers;
—Federal and state regulators should strengthen and make consistent government oversight of entities that originate and fund mortgages and otherwise interface with customers in the mortgage origination process;
—The Federal Reserve should issue stronger consumer protection and disclosure rules;
—Overseers of institutional investors should require investors to obtain from sponsors and underwriters of securitized credits better information about the risk characteristics of such credits, including information about the underlying asset pools;
—Overseers should ensure that these investors develop an independent view of the risk characteristics of the instruments in their portfolios, rather than rely solely on credit ratings;
—The PWG will form a committee to develop best practices regarding disclosure to investors in securitized credits;
—Credit rating agencies (CRAs) should disclose the reviews they perform on originators of assets and should require underwriters to represent the level and scope of due diligence performed on the underlying assets;
—CRAs should publish sufficient information about the assumptions underlying their credit rating methodologies, so that users of credit ratings can understand how a particular credit rating was determined;
—CRAs should provide the information investors need to make informed decisions about risk, including measures of the uncertainty associated with ratings and of potential ratings volatility; and
—The PWG will form a group to develop recommendations for further steps that issuers, underwriters, CRAs, and policymakers could take to ensure the integrity and transparency of ratings, and to foster appropriate use of ratings in risk assessment.

Question. What key ways is your Department proposing to employ to close the "tax gap?" You once stated in a Finance Committee hearing that this is not a pot of gold. How big is the gap and what will it cost to close it?

Answer. The estimated size of the tax gap is as follows. In 2001, the overall compliance rate was estimated at over 86 percent, after late payments and recoveries from IRS enforcement activities. The tax gap results from noncompliance, specifically the amount of tax that should be paid but is not paid. After enforcement efforts and late payments, this amount was approximately $290 billion.

The key ways in which the Treasury Department is proposing to reduce the tax gap were set forth in a comprehensive strategy to improve tax compliance released in September 2006. The strategy builds upon the demonstrated experience and current efforts of the Treasury Department and IRS to improve compliance. Four key principles guided the development of this strategy: both unintentional taxpayer errors and intentional taxpayer evasion should be addressed; sources of non-compliance should be targeted with specificity; enforcement activities should be combined with a commitment to taxpayer service; and tax policy and compliance proposals should be sensitive to taxpayer rights and maintain an appropriate balance between enforcement activity and imposition of taxpayer burden. These principles underscore the Treasury Department's and IRS' comprehensive, integrated, multi-year strategy to improve tax compliance. Components of this strategy include: (1) legislative proposals to reduce opportunities for evasion; (2) a multi-year commitment to compliance research; (3) continued improvements in information technology; (4) improvements in IRS compliance activities; (5) enhancements of taxpayer service; (6) simplification of the tax law; and (7) coordination between the government and its partners and stakeholders.

More specifically, the Treasury Department's fiscal year 2009 Revenue Proposals include a number of legislative proposals intended to improve tax compliance with minimum taxpayer burden. The fiscal year 2009 President's budget does include a number of legislative proposals intended to improve tax compliance with minimum taxpayer imposition. These proposals could generate $36 billion over the next ten years. The Administration proposes to expand information reporting, improve compliance by businesses, strengthen tax administration, and expand penalties.

—*Expand information reporting*.—Compliance with the tax laws is highest when payments are subject to information reporting to the IRS. Specific information reporting proposals would: require information reporting on payments to corporations; require basis reporting on security sales; require information reporting on merchant payment card reimbursements; require a certified Taxpayer Identification Number (TIN) from contractors; require increased information reporting on certain government payments; increase information return penalties; and improve the foreign trust reporting penalty.

—*Improve compliance by businesses*.—Improving compliance by businesses of all sizes is important. Specific proposals to improve compliance by businesses would: require electronic filing by certain large organizations; and implement standards clarifying when employee leasing companies can be held liable for their clients' Federal employment taxes.

—*Strengthen tax administration*.—The IRS has taken a number of steps under existing law to improve compliance. These efforts would be enhanced by specific tax administration proposals that would: expand IRS access to information in the National Directory of New Hires for tax administration purposes; permit disclosure of prison tax scams; make repeated willful failure to file a tax return a felony; facilitate tax compliance with local jurisdictions; extend statutes of limitations where state tax adjustments affect federal tax liability; and improve the investigative disclosure statute.

—*Expand penalties*.—Penalties play an important role in discouraging intentional non-compliance. A specific proposal to expand penalties would impose a penalty on failure to comply with electronic filing requirements.

In the fiscal year 2009 President's budget, the IRS has budgeted over $23 million to implement these proposals. The budget also includes other items relating to the tax gap: over $286 million to reduce the tax gap for large business, small business, and the self-employed sector, to increase compliance of domestic taxpayers with offshore activity, and to minimize revenue loss by increasing document matching efforts; and over $51 million to increase support for research to understand better the reasons for taxpayer non-compliance.

Question. If we simplified our tax code with, for example, a flat income tax, what effect would there be on revenue receipts and revenue collection?

Answer. Replacing the existing income tax with a flat income tax could raise, lower, or leave unchanged tax revenue, depending on such design features as the tax rate imposed by the flat tax. A standard objective of tax reform efforts is to broaden the tax base and reduce tax rates. Generally speaking, the broader the base, the lower tax rates can be and still raise the same revenue as the current tax system. So, for example, eliminating or minimizing special exclusions, exemptions, deductions, and credits allows setting lower tax rates without reducing revenue. Both a broad tax base and lower tax rates are desirable from a policy perspective because they reduce economic distortions caused by the tax system.

Question. Will you commit to working with us and with SEC in preventing U.S. manufacturing companies from purchasing "blood minerals" like coltan from exporters who are abusing and murdering innocent people?

Answer. The Administration shares Congressional concern regarding the conflict in the Democratic Republic of Congo, which has been marked by serious violations of human rights and international law. To address this threat to the foreign policy of the United States, the President declared a national emergency and issued E.O.

13413 (October 27, 2006) implementing sanctions directed at persons contributing to the widespread violence and atrocities in the Democratic Republic of the Congo, as called for by U.N. Security Council Resolutions 1596 of April 18, 2005, and 1649 of December 21, 2005. The E.O. blocks the assets of, and prohibits U.S. persons from engaging in transactions and dealings with, persons listed in the Annex to, or designated pursuant to, the E.O. The Annex to the E.O. listed seven persons, including the notorious international arms dealer Viktor Bout, and OFAC designated an additional seven companies and three individuals pursuant to the E.O. in March 2007. A number of the March 2007 designations specifically related to exploitation of the gold sector in support of armed militia activity. OFAC continues to investigate aggressively the operations and holdings of rogue actors operating in the Democratic Republic of Congo.

Question. Last year, Congress passed and the President signed legislation to give your Office of Foreign Assets Control the ability to levy larger civil and criminal penalties for those who violate sanctions against rogue nations. Have the stronger tools helped provide a greater deterrent for those who would be inclined to deal with countries on whom we have imposed sanctions?

Answer. We appreciate Congressional efforts in increasing the maximum civil penalties available to the Office of Foreign Assets Control and believe that the availability of such meaningful penalties will serve as a meaningful deterrent for those who might otherwise treat civil penalties as merely "the cost of doing business." Indeed, OFAC has conducted several outreach events specifically on this topic. While it is still too soon to assess the full impact of the legislation that was passed last year, we note that there has been significant interest from the media and the general public related to these enhanced penalties.

CONGO/COLTAN

Question. The Office of Foreign Assets Control (OFAC) administers and enforces economic and trade sanctions, based on U.S. foreign policy and national security goals against foreign countries, terrorists, international narcotics traffickers, and those engaged in activities related to the proliferation of weapons of mass destruction.

While the issue of exploited natural resources in the Democratic Republic of Congo, or specifically the issue of coltan may not be an engagement of proliferation of weapons of mass destruction, these activities are some of the most brutal human rights abuses we see in our world today (human-trafficking, child labor, sexual abuse and rape). The product of many of these actions leads to the refined component of a mineral which then ends up in much of our high technology industry here—cell phones, DVD players, flat screen televisions, etc. What are the limitations of OFAC's capabilities to target these rogue actors in eastern Congo?

Answer. Within the framework of E.O. 13413 (October 27, 2006) and related U.N. Security Council Resolutions, the Treasury Department has the authority to designate rogue actors engaging in activities contributing to the violence and atrocities taking place in the Democratic Republic of the Congo. OFAC continues to aggressively investigate the operations and holdings of such rogue actors (including militia leaders and their financial enablers) operating in the Democratic Republic of Congo. Improved access to credible and reliable on-the-ground information pertaining to the business activities of these rogue actors is always vital to OFAC's ability to designate potential targets.

Question. Has OFAC looked into targeting these rogue actors before?

Answer. The Annex to the E.O. 13413 listed seven persons, including the notorious international arms dealer Viktor Bout, and OFAC designated an additional seven companies and three individuals pursuant to the E.O. in March 2007. A number of the March 2007 designations specifically related to exploitation of the gold sector in support of armed militia activity. OFAC continues to investigate aggressively the operations and holdings of rogue actors operating in the Democratic Republic of Congo.

Question. What assistance might OFAC need in this procedure?

Answer. As stated above, access to on-the-ground information pertaining to the business activities of these rogue actors is vital to OFAC's ability to designate potential targets. OFAC is working to enhance its access to this type of information. OFAC as a matter of policy does not comment publicly on its techniques and sources for gathering this type of information.

Question. In regards to the budget, what accountability measures are in place, specifically regarding Congo, to ensure material resources are not siphoned off by these rogue actors? If any, what is Department of Treasury doing to implement these measures?

Answer. Pursuant to E.O.13413 (October 27, 2006), OFAC continues to investigate aggressively the operations and holdings of rogue actors operating in the Democratic Republic of Congo; designated individuals and entities are deprived of access to the U.S. financial system and any transactions involving U.S. persons.

Question. As a former board member of the Nature Conservancy, I know that you have a great interest in natural resource conservation. Would you support protecting parts of the Congo so that its natural resources are not further exploited?

Answer. The Department of the Treasury strongly supporting ongoing efforts to strengthen natural resource management in the Democratic Republic of Congo (DRC), particularly the efforts of the World Bank to encourage reform of the forestry and mining sectors. Some important steps taken to date by the Congolese authorities include establishing a moratorium on new logging titles and the promulgation of new Mining and Forest Codes. Treasury sees these as strong building blocks for longer-term reform and important steps toward filling the legal vacuum with respect to the governance of the Congolese forest and mining sectors. However, the situation in the DRC is extremely challenging and much work remains, including developing appropriate regulatory frameworks and strong institutions to manage these sectors. Treasury will continue to urge the World Bank to work with the Congolese authorities on the issue of natural resource management.

Further, the United States is a founding member and financial supporter of the Congo Basin Forest Partnership (CBFP) which brings together governments, the private sector, civil society and development organizations to conserve the unique natural resources of the Congo Basin, fight illegal logging and poaching, and improve the livelihoods of the Basin's 100 million inhabitants. The Department of Treasury respectfully refers you to the State Department and USAID for additional information, as they are the lead U.S. government agencies with regard to our involvement in the CBFP.

SUBCOMMITTEE RECESS

Secretary PAULSON. We will, and I thank you very much for the way you have supported Treasury's budget. And thank you very much.

Senator DURBIN. Thanks, Mr. Secretary. This meeting of the Subcommittee on Financial Services and General Government will stand recessed.

[Whereupon, at 4 p.m., Wednesday, March 5, the subcommittee was recessed, to reconvene subject to the call of the Chair.]